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EDITOR'S NOTE

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No. 86-1521-ADX
Status: GRANTED

Title: United States, Appellant
v.
Wells Fargo Bank, et al.

Docketed:
March 19, 1987

Court: United States District Court for the Central District of California

Counsel for appellant: Solicitor General

Counsel for appellee: Ancel,Mark G., Rotstein,Robert H.

Entry	Date	Note	Proceedings and Orders
1	Jan 8 1987		Application for extension of time to docket appeal and order granting same until March 19, 1987 (O'Connor, January 12, 1987).
2	Mar 19 1987	G	Statement as to jurisdiction filed.
4	Apr 24 1987		Memorandum of appellees Crocker National Bank, et al. filed.
3	Apr 25 1987		Memorandum of appellees Harry Rosenberg and Arthur Rosen filed.
5	Apr 29 1987		DISTRIBUTED. May 14, 1987
7	May 12 1987	G	Motion of appellees to substitute Wells Fargo Bank, et al. in place of Crocker National Bank, et al. filed.
8	May 18 1987		Motion of appellees to substitute Wells Fargo Bank, et al. in place of GRANTED.
9	May 18 1987		PROBABLE JURISDICTION NOTED.
10	Jun 1 1987	G	Motion of the Solicitor General to dispense with printing the joint appendix filed.
11	Jun 15 1987		Motion of the Solicitor General to dispense with printing the joint appendix GRANTED.
13	Jun 29 1987		Order extending time to file brief of appellant on the merits until August 1, 1987.
15	Jul 31 1987		Order extending time to file brief of appellant on the merits until August 1, 1987.
16	Aug 6 1987		Record filed.
17	Aug 8 1987		Record filed.
18	Aug 13 1987		Brief of appellant filed.
20	Aug 27 1987		Order extending time to file brief of appellee on the merits until October 28, 1987.
21	Oct 9 1987		SET FOR ARGUMENT. Tuesday, December 8, 1987. (4th case).
22	Oct 28 1987		Brief amicus curiae of American College of Probate Counsel filed.
23	Oct 28 1987		Brief of appellees Rosenberg and Rosen filed.
24	Oct 28 1987		Brief amicus curiae of Keith D. Graham filed.
25	Oct 28 1987		Brief amici curiae of Estate of Dorothy Dillon, et al. filed.
26	Oct 28 1987		Brief of appellees Wells Fargo Bank, et al. filed.
28	Oct 28 1987		Brief amici curiae of Herbert K. Cummings, et al. filed.
29	Oct 28 1987		Brief amici curiae of Executors of the Estate of Marion Du Pont Scott filed.
30	Oct 28 1987		Copy of Summary rpt. - Lodging received.
27	Oct 30 1987		CIRCULATED.

No. 86-1521-ADX

Entry	Date	Note	Proceedings and Orders
31	Dec 1 1987	X	Reply brief of appellant United States filed.
33	Dec 8 1987		ARGUED.

JURISDICTIONAL

STATEMENT

86 1521

No.

Supreme Court, U.S.
FILED
MAR 19 1987
JOSEPH F. SPANIOL, JR.
CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1986

UNITED STATES OF AMERICA, APPELLANT

v.

CROCKER NATIONAL BANK, ET AL.

UNITED STATES OF AMERICA, APPELLANT

v.

HARRY ROSENBERG AND ARTHUR ROSEN, ETC.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE CENTRAL DISTRICT OF CALIFORNIA

JURISDICTIONAL STATEMENT

CHARLES FRIED
Solicitor General

ROGER M. OLSEN
Assistant Attorney General

ALBERT G. LAUBER, JR.
Deputy Solicitor General

ALAN I. HOROWITZ
Assistant to the Solicitor General

MICHAEL L. PAUP
ERNEST J. BROWN
Attorneys

Department of Justice
Washington, D.C. 20530
(202) 633-2217

50pp

QUESTIONS PRESENTED

1. Whether obligations of public housing agencies owned by the decedents were excludable from their gross estates for purposes of the federal estate tax by virtue of the United States Housing Act of 1937, as amended.

2. If the first question is answered in the affirmative, whether Section 641(b)(2) of the Deficit Reduction Act of 1984 violates the Fifth Amendment in making such obligations includible in the gross estates of decedents who died before that provision's effective date, but whose representatives reported those obligations on their estate tax returns as part of the gross estate.

PARTIES TO THE PROCEEDING

Crocker National Bank, Lew R. Wasserman and Ruth S. Cogan were all plaintiffs in District Court No. CV 85-7614 as Executors of the Will of Jules C. Stein. Harry Rosenberg and Arthur Rosen were plaintiffs in District Court No. CV 85-3465 as co-trustees of the Morris and Tillie Folb Trust, FBO Tillie Folb.

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In the Supreme Court of the United States

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UNITED STATES OF AMERICA, APPELLANT

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UNITED STATES OF AMERICA, APPELLANT

v.

HARRY ROSENBERG AND ARTHUR ROSEN, ETC.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE CENTRAL DISTRICT OF CALIFORNIA

JURISDICTIONAL STATEMENT

OPINION BELOW

The opinion of the district court (App., *infra*, 1a-18a) is unofficially reported at 86-2 U.S.Tax Cas. (CCH) ¶ 13,703.

JURISDICTION

The judgments of the district court (App., *infra*, 19a-20a) were entered on October 20, 1986. The notices of appeal to this Court were filed on November 19, 1986 (App., *infra*, 21a-24a). On January 12, 1987, Justice O'Connor extended the time for docketing the appeals to and including March 19, 1987. The jurisdiction of this Court is invoked under 28 U.S.C. 1252.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The relevant constitutional and statutory provisions are set out in a statutory appendix (App., *infra*, 25a-27a).

STATEMENT

1. These appeals are taken from judgments in two cases that were consolidated in the district court. They present identical legal issues relating to the estate tax treatment of certain short-term obligations of public housing agencies ("Project Notes"). These Project Notes are exempted from some – but, we believe, not all – federal taxation by the Housing Act of 1937, as amended.

Appellees in the *Crocker* case are the executors under the will of Jules C. Stein, who died on April 29, 1981. At the time of his death, Stein owned $9,500,000 face amount in Project Notes, which matured on various dates in 1981 subsequent to his death. On January 29, 1982, appellees filed a federal estate tax return for Stein's estate. On that return, appellees included these Project Notes, plus accrued interest, in the gross estate. The return showed as due, and appellees paid, estate tax in the amount of $10,874,767, a sum that reflected appellees' belief that the Project Notes were subject to tax. Two and a half years later, on June 29, 1984, appellees filed a claim for refund of $1,320,097 in estate tax, plus interest. This refund claim was premised on the assertion that the Project Notes were exempt from estate tax and should not have been included in the gross estate. The Commissioner denied the refund claim. App., *infra*, 3a.

Appellees in the *Rosenberg* case were co-executors of the estate of Morris Folb, who died on July 1, 1982, and are co-trustees of a trust to which Folb's net estate was distributed. At the time of his death, Folb owned $250,000 face amount in Project Notes, which matured on various

dates in 1982 subsequent to his death. On March 30, 1983, appellees filed a federal estate tax return for Folb's estate. On that return, appellees included these Project Notes, plus accrued interest, in the gross estate. The return showed as due, and appellees paid, estate taxes in the amount of $221,519, a sum that reflected appellees' belief that the Project Notes were subject to tax. More than a year later, on August 15, 1984, appellees filed a claim for refund of $84,596 in estate tax, plus interest. This refund claim was premised on the assertion that the Project Notes were exempt from estate tax and should not have been included in the gross estate. The Commissioner denied the refund claim. App., *infra*, 2a-3a.

2. The refund claims in these cases were triggered by the district court decision in *Haffner* v. *United States*, 585 F. Supp. 354 (N.D. Ill. 1984), aff'd, 757 F.2d 920 (7th Cir. 1985), which held that comparable Project Notes were not includible in a decedent's gross estate for estate tax purposes. The district court in *Haffner* bottomed its decision on what is now Section 11(b) of the Housing Act of 1937, 42 U.S.C. 1437i(b), enacted in its original form as Section 5(e) of the Housing Act of 1937, ch. 896, 50 Stat. 890. Section 5(e) provided that Project Notes "shall be exempt from all taxation now or hereafter imposed by the United States." The *Haffner* court acknowledged the "general rule * * * that an exemption from all taxation generally does not affect the imposition of estate and other excise taxes" (585 F. Supp. at 356-357). It viewed Section 5(e) as different, however, because of what it found to be a "strong indication" (*id.* at 357) that Congress in 1937 intended to exempt Project Notes from federal estate taxation.

The *Haffner* court relied primarily on the difference in language between Section 5(e) of the 1937 Act and Section 20(b) of that law. The latter section (50 Stat. 898) provided that obligations of the United States Housing Authority

"shall be exempt * * * from all taxation (except surtaxes, estate, inheritance, and gift taxes) now or hereafter imposed by the United States or by any State * * * or local taxing authority." The court reasoned that the absence in Section 5(e) of an explicit proviso like that contained in Section 20(b) indicated a congressional intent to exempt Project Notes from estate tax. 585 F. Supp. at 357-360. The court also relied in part on an explanation of the 1937 legislation on the floor of the Senate by Senator Walsh, who stated that the obligations of public housing agencies would be tax-exempt, "which means they are free from income tax surtax, estate, gift, and inheritance taxes" (81 Cong. Rec. 8085 (1937), quoted in 585 F. Supp. at 359). And the court noted that an alternate version of Section 5(e) submitted to the Senate Committee had expressly subjected Project Notes to the estate tax (585 F. Supp. at 358). Hence, the *Haffner* court concluded that Project Notes had been exempt from estate and gift taxation continuously since 1937, inasmuch as Congress had never acted to change that supposed tax-exempt status.

Congressional reaction to the unprecedented holding of the district court in *Haffner* was swift. Noting that it was "extremely concerned" by the decision (Staff of the Joint Comm. on Taxation, 98th Cong., 2d Sess., *General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984*, at 971 (Joint Comm. Print 1984)), Congress enacted legislation within three months to overturn the *Haffner* decision. Section 641(a) of the Deficit Reduction Act of 1984 (DEFRA), Pub. L. No. 98-369, 98 Stat. 939, entitled "Clarification of Treatment," provides:

> *General Rule.*—Nothing in any provision of law exempting any property (or interest therein) from taxation shall exempt the transfer of such property (or interest therein) from Federal estate, gift, or generation-skipping transfer taxes.

Section 641(b)(1) makes this provision applicable to the estates of decedents dying, and to gifts and transfers

made, on or after June 19, 1984, which appears to be the date on which the legislation was approved by the Conference Committee (98 Stat. 939).[1] Section 641(b)(2) also makes the provision applicable to estates of decedents dying, and to gifts and transfers made, prior to June 19, 1984, "if at any time there was filed an estate or gift tax return showing such transfers as subject to Federal estate or gift tax." Section 641(b)(3) provides that no inference should be drawn from the statute as to the taxability of transfers made prior to June 19, 1984. And Section 642 required taxpayers to report all transfers of Project Notes occurring after December 31, 1983, and before June 19, 1984 (98 Stat. 939-940).

Thus, the effect of the 1984 amendments was to overturn the result of *Haffner* (1) prospectively and (2) for any case in which a taxpayer or his estate had filed a tax return reflecting a belief that the Project Notes were in fact subject to transfer tax. The DEFRA provisions do not address the gift and estate tax treatment of Project Notes transferred, or held by persons dying, before June 19, 1984, in circumstances where no tax return was filed showing the Project Notes as being subject to tax.

3. Against this statutory background, appellees brought these refund suits in the United States District Court for the Central District of California. Relying on *Haffner*,[2] appellees urged that the Project Notes should not have been included in their decedents' gross estates. With respect to DEFRA, appellees argued that it should not be construed to apply retroactively to the estates in this case and, if it did so apply, that the application of the

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[1] The Conference Committee Report was issued on June 23, 1984. The statute was passed by both Houses of Congress on June 27, 1984, and was signed into law on July 18, 1984.

[2] Subsequent to the enactment of DEFRA, *Haffner* was affirmed by a divided panel of the court of appeals, with the majority adopting the district court's opinion with minor corrections (757 F.2d 920 (7th Cir. 1985)). Judge Posner dissented (*id.* at 921-923).

statute was unconstitutional because it was violative of the Fifth Amendment. The government argued that *Haffner* was wrongly decided and that Project Notes were subject to estate taxation. In the alternative, if *Haffner* were held to have been correctly decided, the government argued that DEFRA required that the Project Notes be held to have been properly included in the decedents' gross estates.

The district court granted appellees' motions for summary judgment. Adopting the reasoning and analysis of the district court opinion in *Haffner*, the district court here held that the Project Notes were exempt from federal estate taxation under the Housing Act of 1937 (App., *infra*, 18a). The court further held that Section 641(a) of DEFRA was intended to make the estate tax applicable to Project Notes owned by the estates involved here (App., *infra*, 5a-8a). Finally, the district court concluded that such a retroactive application of the 1984 statute was unconstitutional.

The court identified two constitutional infirmities in the DEFRA amendment. First, the court concluded that the retroactive application of Section 641(a) violates the Due Process Clause of the Fifth Amendment (App., *infra*, 9a-14a). The court recognized that "[t]here is nothing unusual about retroactive tax laws" (*id.* at 9a). It found, however, that "the retroactive removal of the exemption from estate tax equals the imposition of a wholly new tax." It therefore concluded that this Court's decision in *Untermyer* v. *Anderson*, 276 U.S. 440 (1928), which invalidated the retroactive application of the first gift tax, "compels the court to find that retroactive application of Section 641 is arbitrary and invalid under the due process clause of the Fifth Amendment" (App., *infra*, 13a).

Second, the court ruled that the application of DEFRA in this case violates the equal protection component of the Fifth Amendment (App., *infra*, 14a-17a). The court noted that the statute draws a distinction between two otherwise

identical estates that differ only in whether they had listed Project Notes as assets includible in their taxable estates. The court said that there was "absolutely no rational basis" for this distinction (*id.* at 16a). The court did not deny that the evident purpose of the distinction drawn in the statute was to prevent persons from "join[ing] the bandwagon in the wake of *Haffner* in anticipation of a windfall." But the court found such a legislative purpose to be inadequate to justify the statutory distinction because "[t]o deny persons those windfalls based on speculation about the legal position that they have taken is impermissable" (*ibid.*).

THE QUESTION IS SUBSTANTIAL

The district court has squarely invalidated a federal tax statute on grounds of repugnancy to the Constitution. Although the statute is, in a sense, transitional legislation that diminishes in importance with the passage of time, the rationale of the district court's decision is a sweeping one that has broad ramifications. The court has held that any legislation that eliminates a claimed tax preference—including one not previously relied upon by the taxpayer, or of which he was not even aware—is unconstitutional to the extent that it does not operate in a purely prospective fashion. This holding would disable Congress from enacting curative legislation to prevent taxpayers from obtaining windfall benefits from erroneous court decisions. And the equal protection aspect of the court's opinion eviscerates Congress's authority to draw rational distinctions designed to reflect the degree to which the legislation may interfere with the different expectations of different classes of taxpayers. The decision below thus threatens to affect adversely the structure of the revenue laws by circumscribing what has heretofore been recognized as the unquestioned prerogative of Congress in enacting tax legislation.

Moreover, apart from the broader ramifications of the district court's rationale, the invalidation of the statute at issue here independently presents an important issue that requires resolution by this Court. The tax consequences of the holding are quite substantial in dollar terms.[3] And there has already been considerable litigation concerning the statute at issue here, litigation that to date has yielded highly divergent outcomes.[4]

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[3] We have been informed by the Internal Revenue Service that there are currently pending, administratively or in court, approximately 160 estate and gift tax cases involving over $260 million in Project Notes. And because the statute of limitations governing assertions of deficiencies and refund claims for estate taxes of decedents dying prior to June 19, 1984, has not yet run, those numbers may well increase.

[4] The issues presented here have been raised and (thus far) decided in three other district court cases, each of which reached a result different from that reached by the district court below. In *Shackelford* v. *United States*, 649 F. Supp. 1347 (E.D. Va. 1986), appeal pending, No. 87-2512 (4th Cir.), where the taxpayer sought a refund of more than $22 million in estate taxes, the court held that *Haffner* was wrongly decided and that Project Notes have always been subject to estate taxation. Accordingly, the court had no occasion to consider the applicability or the constitutionality of DEFRA. In *Netsky* v. *United States*, 58 A.F.T.R. 2d (P-H) ¶ 148,467 (E.D. Pa. 1986), appeal pending, No. 86-1616 (3d Cir.), the district court held that *Haffner* was correctly decided. Noting its view that retroactive application of Section 641(a) of DEFRA would be unconstitutional, the court held that the statute should not be construed to apply retroactively to estates that had filed claims for refund before the effective date. In *Estate of Bradford* v. *United States*, 645 F. Supp. 476 (N.D. Cal. 1986), appeal pending No. 86-2634 (9th Cir.), the court also followed *Haffner*, though it termed the question whether Project Notes were exempted from estate taxation by the Housing Act of 1937 "a close one." The court concluded, however, that Section 641(a) of DEFRA applied to require the inclusion of Project Notes in the gross estate and further concluded that the retroactive application of DEFRA was constitutional. Thus, the four district courts that to date have ruled on refund claims based on *Haffner* for estate taxes shown on returns filed before DEFRA have reached four mutually inconsistent results.

1. Before the provisions of DEFRA, and the attendant questions about their constitutionality, come into play, there exists the threshold question of whether the Housing Act of 1937 actually exempted Project Notes from federal estate taxation. If the district court was mistaken in giving an affirmative answer to that threshold question, then appellees' refund claims here must fail irrespective of DEFRA. An appeal under 28 U.S.C. 1252 of course brings the entire case before the Court. *United States* v. *Locke*, 471 U.S. 84, 92 (1985). Therefore, we begin by discussing this threshold statutory question in accordance with this Court's usual practice of first confronting statutory issues whose resolution may obviate the need to consider constitutional claims. See, *e.g.*, *United States* v. *Locke*, 471 U.S. at 92; *Ashwander* v. *TVA*, 297 U.S. 288, 347 (1936) (Brandeis, J., concurring).

The conclusion that the Housing Act of 1937 exempted Project Notes from estate taxation is not supported by the terms of that statute and creates a significant dislocation in the overall scheme of federal taxation. It is established beyond doubt that general language exempting particular property from taxation, like that contained in Section 5(e) of the Housing Act of 1937, does not operate to prohibit the imposition of an excise tax on the *transfer* of that property, such as an estate tax or a gift tax. See, *e.g.*, *United States Trust Co.* v. *Helvering*, 307 U.S. 57 (1939); *Murdock* v. *Ward*, 178 U.S. 139 (1900). The *Haffner* decision recognized this general rule, but deviated from it because of some peculiarities that the court discerned in the language of other sections of the 1937 Act and in the Act's legislative history. The court's interpretation is flawed for several reasons.

First, the federal estate tax has never incorporated any express exemption for any type of securities owned by a

citizen or resident alien,[5] and it is well settled that "[e]xemptions from taxation do not rest upon implication" (*United States Trust Co.* v. *Helvering*, 307 U.S. at 60 (footnote omitted)). Moreover, the legislative history evidence relied on by the *Haffner* courts is extremely flimsy. As Judge Posner convincingly demonstrated in his dissent (757 F.2d at 921-923), an in-depth examination of the context of these "ambiguous tidbits" (*id.* at 922) shows that they provide little, if any, support for the view that Congress in 1937 sought to exempt Project Notes from federal estate taxation.

For example, the difference in language between Sections 5(e) and 20(b) of the Housing Act of 1937 provides no support for the *Haffner* courts' result. That difference is traceable to the need for Section 20(b) to make specific reference to the income tax "surtax" in existence at that time in order to make that surtax applicable to United States Housing Authority obligations. On the other hand, because Congress did not wish to subject Project Notes to

[5] Since the estate tax was first imposed in 1916, its provisions have rarely excluded any specified types of property owned by a citizen or resident alien decedent from the gross estate, and for more than 20 years have excluded none. The Revenue Act of 1918, ch. 18, § 402(f), 40 Stat. 1098, which first included in the gross estate the proceeds of life insurance taken out by the decedent, excluded up to $40,000 receivable by beneficiaries other than the decedent's estate. That exclusion was removed by the Revenue Act of 1942, ch. 619, § 404, 56 Stat. 944. The Revenue Act of 1934, ch. 277, § 404, 48 Stat. 754, excluded from the gross estate "real property situated outside the United States." That exclusion was repealed by the Revenue Act of 1962, Pub. L. No. 87-834, § 18, 76 Stat. 1052. No securities of any sort have ever been excluded from the gross estates of citizens or resident aliens. To the best of our knowledge, the two exclusions described above are the only ones ever recognized for items owned by a citizen or resident alien decedent, if, indeed, the proceeds of life insurance can properly be characterized as "owned" by the decedent. Cf. 26 U.S.C. 2042 (specifically including life insurance proceeds in the gross estate).

the income tax "surtax," it was unnecessary to make any reference to it in Section 5(e) (see 757 F.2d at 922). And Senator Walsh's statement on the floor of the Senate appears to reflect not the establishment of a unique estate tax exemption for Project Notes, but rather the Senator's own misunderstanding of the ordinary connotation of the term "tax-exempt" (*ibid.*).

Finally, the exemption found by the *Haffner* courts is difficult to justify from the standpoint of tax policy or common sense. Such an exemption would enable taxpayers to avoid the estate tax at will simply by converting their wealth into Project Notes (of which there have been billions outstanding) shortly before their death. The exemption would thus frustrate the purpose of the estate tax to inhibit the concentration of wealth (see, *e.g.*, S. Surrey, W. Warren, P. McDaniel & H. Gutman, *Federal Wealth Transfer Taxation* 3-6 (2d ed. 1982)). Furthermore, common sense suggests some implausibility in the *Haffner* courts' discovery, in the early 1980s, of an estate tax exemption that had gone unclaimed by taxpayers, unacknowledged by the IRS, and unrecognized by the courts for some 45 years. Generally speaking, tax exemptions of billion-dollar magnitude do not lay dormant for such extended periods of time, invisible to the ever-watchful eyes of the private tax bar. Thus, quite apart from DEFRA, the district court erred in holding that the Housing Act of 1937 entitled appellees to omit the Project Notes from their decedents' gross estates.[6]

[6] Although it does not of course present a discrete basis for direct appeal, this threshold statutory question would independently warrant review by this Court because of its substantial revenue consequences. There are numerous estates whose decedent died prior to the effective date of DEFRA, but whose estate tax return was not due until after *Haffner* was decided, thus giving the executors the opportunity to omit Project Notes from the gross estate and thereby avoid being covered by DEFRA. A large portion of the $260 million in Project

2. a. The district court clearly erred in concluding that Section 641(a) of DEFRA violates the Due Process Clause. It is well established that the mere fact that legislation has some retroactive application does not establish a constitutional violation. As this Court stated in *Pension Benefit Guaranty Corp.* v. *R.A. Gray & Co.*, 467 U.S. 717, 729 (1984):

> [T]he strong deference accorded legislation in the field of national economic policy is no less applicable when that legislation is applied retroactively. Provided that the retroactive application of a statute is supported by a legitimate legislative purpose furthered by rational means, judgments about the wisdom of such legislation remain within the exclusive province of the legislative and executive branches.

These principles apply with full force to the tax laws; indeed, tax legislation regularly contains some elements of retroactivity. See, *e.g.*, *United States* v. *Darusmont*, 449 U.S. 292, 296-299 (1981); *Welch* v. *Henry*, 305 U.S. 134, 146-150 (1938); *Milliken* v. *United States*, 283 U.S. 15, 24 (1931). The retroactive application of a tax is unconstitutional only if it is found to be "harsh and oppressive." *United States* v. *Hemme*, No. 84-1944 (June 3, 1986); *Welch* v. *Henry*, 305 U.S. at 147.

The district court did not point, and it could not point, to anything suggesting that the retroactive application of Section 641 is "harsh and oppressive." To the contrary, the statute is designed simply to avoid giving taxpayers a windfall benefit as a result of a judicial decision that

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Notes involved in pending litigation are held by estates to which DEFRA does not apply, and that amount can be expected to increase substantially until the period for asserting deficiencies expires. Moreover, while there is not yet a conflict in the circuits on this issue, that situation is likely to change with appeals now pending in three circuits outside the Seventh Circuit and an increasing number of cases pending in the trial courts. See note 4, *supra*.

postulated (we believe erroneously) a previously unrecognized estate tax exemption. And even with respect to that narrow objective, the scope of the statute's retroactive application is confined to those taxpayers who had already reported the Project Notes as taxable on a tax return filed with the IRS. Hence, the statute does not affect any taxpayer who may have taken action prior to June 19, 1984, on the assumption that Project Notes were immune from estate and gift tax. The statute therefore upsets no settled expectations; it does no more than restore the status quo ante the district court's decision in *Haffner*. There is nothing "harsh and oppressive" about a statute that merely holds a taxpayer to his own treatment of items on a tax return that he himself prepared.

The district court's reliance on *Untermyer* v. *Anderson*, 276 U.S. 440 (1928), is quite mistaken. As the district court itself recognized (App., *infra*, 12a), *Untermyer* stands, at most, for the proposition that a "wholly new tax" cannot be imposed retroactively on transactions completed before the new tax is enacted. See, *e.g.*, *United States* v. *Hemme*, slip op. 9 (distinguishing *Untermyer*); *United States* v. *Darusmont*, 449 U.S. at 299-300 (same); *Milliken* v. *United States*, 283 U.S. at 21 (same).[7] The

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[7] Following this Court's lead, the courts of appeals, if not questioning the continuing validity of *Untermyer*, have uniformly viewed it as applying only to the retroactive application of a wholly new tax. See, *e.g.*, *Fein* v. *United States*, 730 F.2d 1211, 1213-1214 (8th Cir.), cert. denied, 469 U.S. 858 (1984) ("the modern trend of decisions has uniformly been to limit" *Untermyer* to the "narrow situation" there involved); *Estate of Ceppi* v. *Commissioner*, 698 F.2d 17, 21 (1st Cir.), cert. denied, 462 U.S. 1120 (1983) (collecting cases and concluding that, in light of this Court's subsequent decision in *Milliken*, "*Untermyer* at best remains good law only for the proposition that a wholly new gift tax cannot be applied retroactively"); *Westwick* v. *Commissioner*, 636 F.2d 291, 292 (10th Cir. 1980) (limiting *Untermyer* to "wholly new types of taxes"); *Buttke* v. *Commissioner*, 625 F.2d 202, 203 (8th Cir. 1980), cert. denied, 450 U.S. 982 (1981) (reading

district court's assertion that Section 641 of DEFRA "amounts to" the imposition of a "wholly new tax" (App., *infra,* 12a) is completely unsupportable. The fact is that DEFRA made no more than a slight change in the long-existing estate tax (if it made any change at all (see pages 9-11, *supra*)). The decedents here at all times knew that the transfer of their estates would be subject to estate tax, and they knew that the value of property interests held at death generally would be includible in the gross estate. See 26 U.S.C. 2001, 2031 and 2033. A legislative alteration of this scheme to eliminate a supposed exemption for a particular type of property is not the establishment of a "wholly new tax." Rather, it is precisely the type of adjustment in the existing tax structure that this Court repeatedly has held may be effected retroactively without violating any due process rights.

The district court's assertion that these cases "present far more egregious factual situations than *Untermyer*" (App., *infra,* 13a) is similarly untenable. This assertion appears to rest on the fact that the taxpayer in *Untermyer,* because legislation to enact a gift tax was pending in Congress at the time he made his gift, could have anticipated that a gift tax would be enacted. On the other hand, the decedents here "could not have foreseen the enactment * * * of DEFRA's provisions taxing the Project Notes" (App., *infra,* 14a). But even if one assumes arguendo that foreseeability or "personal notice" may sometimes be material in assessing the constitutionality of a retroactive

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Untermyer to bar "retroactive application of a wholly new tax"); *Sidney* v. *Commissioner,* 273 F.2d 928, 932 (2d Cir. 1960) (Friendly, J.) ("If Untermyer remains authority at all, it is so only for the particular situation of a wholly new type of tax."). See generally Hochman, *The Supreme Court and the Constitutionality of Retroactive Legislation,* 73 Harv. L. Rev. 692 (1960); Ballard, *Retroactive Federal Taxation,* 48 Harv. L. Rev. 592 (1935).

tax (see *Darusmont,* 449 U.S. at 299), it is completely irrelevant here. For while it is true that the instant decedents, prior to their death, could not have foreseen the enactment of DEFRA, it is also evident that they did not foresee the opinion in *Haffner* either—their executors, after all, included the Project Notes in their taxable estates. In assessing whether the effect of Section 641 is "harsh and oppressive," therefore, it is immaterial that these decedents were not aware of Congress's plan to *repeal* the supposed exemption for Project Notes, since these decedents manifested no awareness that the supposed exemption existed to begin with. Moreover, even if the decedents had entertained a subjective expectation that their Project Notes would be immune from estate tax, that expectation would not have been reasonable since, as we explain above (pages 9-11, *supra*), there was little basis for that view before (or, for that matter, after) the district court's decision in *Haffner*. In sum, it was not "harsh and oppressive" for Congress to implement its intent that Project Notes be included in the gross estate just like other forms of property.

b. The district court's holding that Section 641(a) of DEFRA violates Fifth Amendment equal protection principles is equally unsupportable. The distinction drawn by Congress between persons who had reported Project Notes on a federal tax return as being subject to estate or gift tax, and those who had not done so, was designed to eliminate any possible perception of unfairness in the statute's retroactive application. Congress thereby ensured that DEFRA would not operate retroactively against any taxpayer who might reasonably be thought to have acted in reliance on the assumption that Project Notes were exempt from transfer taxes, while preventing a rush to the courts by taxpayers who, having previously manifested a belief that Project Notes were subject to tax, sought to secure a windfall based on *Haffner*. If this legislative purpose is not

"rational," Congress's ability to cure erroneous statutory interpretations retroactively will be severely circumscribed. Accordingly, this case presents substantial questions concerning the power of Congress to enact curative tax legislation, and the broad ramifications of the district court's decision require review by this Court.

CONCLUSION

Probable jurisdiction should be noted.

Respectfully submitted.

CHARLES FRIED
Solicitor General
ROGER M. OLSEN
Assistant Attorney General
ALBERT G. LAUBER, JR.
Deputy Solicitor General
ALAN I. HOROWITZ
Assistant to the Solicitor General
MICHAEL L. PAUP
ERNEST J. BROWN
Attorneys

MARCH 1987

APPENDIX A

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

CASE NO. CV 85-3465 CBM

HARRY ROSENBERG AND ARTHUR ROSEN, CO-TRUSTEES OF THE MORRIS AND TILLIE FOLB TRUST, FBO TILLIE FOLB, PLAINTIFFS,

v.

UNITED STATES OF AMERICA, DEFENDANT.

CASE NO. CV 85-7614 CBM

CROCKER NATIONAL BANK, A NATIONAL BANKING ASSOCIATION, LEW R. WASSERMAN, AND RUTH S. COGAN, AS EXECUTORS OF THE WILL OF JULES C. STEIN, DECEASED. PLAINTIFFS,

v.

UNITED STATES OF AMERICA, DEFENDANT.

[Filed OCT. 20, 1986]

CONSOLIDATED MEMORANDUM OPINION GRANTING PLAINTIFFS' MOTIONS FOR SUMMARY JUDGMENT

Plaintiffs in both cases are the executors of decedents' estates that includes various public housing agency Project Notes issued pursuant to the Housing Act of 1937, P.L. 75-412 (1937) ("Project Notes"). Both Plaintiffs treated their respective Project Notes as subject to federal estate tax and accordingly paid estate taxes thereon. Subsequent

to the filing of the estate tax returns, a district court in the Northern District of Illinois, Eastern Division, ruled that public housing Project Notes issued pursuant to the Housing Act of 1937 are exempt from federal estate tax under Section 11(b) of the Act. *Haffner v. United States*, 585 F. Supp. 354 (N.D. Ill. 1984), *aff'd*, 757 F.2d 920 (7th Cir. 1985). Based on the *Haffner* decision, plaintiffs instituted these actions seeking a refund of the estate taxes paid to the extent attributable to the Project Notes.

The issues presented are: (1) whether Sections 641(a) and 641(b) of the Deficit Reduction Act of 1984 preclude the recovery of the estate taxes sought in this suit, and (2) whether the court should follow the *Haffner* decision and thus find that Section 11(b) of the Housing Act of 1937 exempts the Project Notes from federal estate taxes.

Although these two actions are not otherwise related, the issues raised are identical. Therefore, these actions are consolidated for purposes of the cross-motions for summary judgment.

FACTS

(1) *Rosenberg*, No: 85-3465

The decedent, Morris Folb, died on July 1, 1982. On March 30, 1983, his executors, plaintiffs Harry Rosenberg and Arthur Rosen, filed a federal estate tax return. Decedent's estate included twenty federally insured local public housing agency Project Notes issued pursuant to the Housing Act of 1937, P.L. No. 75-412 (1937) ("the 1937 Act"). The Project Notes, worth approximately $250,000, were reported on the estate tax return and the estate paid estate taxes on the value of the Project Notes and accrued interest.

On August 14, 1984, the plaintiffs filed a claim with the District Director of the Internal Revenue Service for refund of the $84,596.32 in estate taxes paid on the Project Notes plus interest at the legal rate from March 30, 1983,

until paid. Plaintiffs base their claim of right to a refund on the theory that the Project Notes and accrued interest are exempt from estate taxes under 42 U.S.C. Section 1437i(b) for the reasons found compelling in *Haffner v. United States*, 585 F. Supp. 354, *aff'd*, 757 F.2d 920 (7th Cir. 1985). Plaintiffs received no notice of disallowance of their claim for refund in the six month period following the filing of their claim for refund, nor has defendant refunded any part of the sum to which plaintiffs claim a right of refund. The instant lawsuit was filed on May 23, 1985 and a hearing was held on April 28, 1986 on the parties' cross-motions for summary judgment.

(2) *Crocker*, No 85-7614:

Plaintiffs are the executors of the will of Jules C. Stein, deceased, who died on April 29, 1981. Decedent's estate included $9,784,571.64 in local public housing agency Project Notes, issued pursuant to the 1937 Act. On January 29, 1982, the plaintiffs filed a federal estate tax return for the decedent's estate. The plaintiffs reported the Project Notes on the decedent's estate tax return and paid estate tax on the Notes in the sum of $1,320,096.58.

On June 29, 1984 plaintiff filed a claim for refund of the federal estate tax paid on the Project Notes. The claim was based on the holding of the district court in *Haffner*. On May 14, 1985, the plaintiffs agreed to an "Acceptance of Proposed Disallowance of Claim for Refund or Credit" and a "Waiver of Statutory Notification of Claim Disallowance." The government thus disallowed plaintiffs claim for overpayment.

Plaintiffs brought the instant action on November 20, 1985. On January 27, 1986, the Government filed a motion to dismiss for failure to state a claim pursuant to Fed. R. Civ. P. 12(b)(6). After a hearing on the motion on

April 28, 1986, the court informed the parties that it would allow both parties to join the cross-motions for summary judgment filed in *Rosenberg*. Both parties subsequently joined the respective cross-motions for summary judgment, and accordingly filed supplemental pleadings thereon.

DISCUSSION

I. WHETHER SECTION 641 OF THE DEFICIT REDUCTION ACT OF 1984 (DEFRA) PRECLUDES THE RECOVERY OF THE ESTATE TAXES SOUGHT IN THE INSTANT LAWSUITS.

Section 641 provides:

> (a) GENERAL RULE – Nothing in any provision of law exempting any property (or interest therein) from taxation shall exempt the transfer of such property (or interest therein) from Federal estate, gift, and generation-skipping transfer taxes. In the case of any provision of law enacted after the date of the enactment of this Act, such provision shall not be treated as exempting the transfer of property from Federal estate, gift, and generation-skipping transfer taxes unless it refers to the appropriate provisions of the Internal Revenue Code of 1954.
>
> (b) EFFECTIVE DATE –
>
> (1) IN GENERAL. – The provisions of subsection (a) shall apply to the estates of decedents dying, gifts made, and transfers made on or after June 19, 1984.
>
> (2) TREATMENT OF CERTAIN TRANSFERS TREATED AS TAXABLE. – The provisions of subsection (a) shall also apply in the case of any transfer of property (or interest therein) if at any time there was filed an estate or gift tax return showing such transfer as subject to Federal estate or gift tax.

> (3) NO INFERENCE – No inference shall arise from paragraphs (1) and (2) that any transfer of property (or interest therein) before June 19, 1984, is exempt from Federal estate and gift taxes.

Section 641 was a direct Congressional reaction to the *Haffner* district court decision.[1] *General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984*, H.R. 4170, 98th Cong. (Dec. 31, 1984), *reprinted in* "TAX REFORM ACT of 1984, General Explanation of the Revenue Provisions, Prepared by the Staff of the Joint Committee of Taxation," CCH Standard Federal Tax Reports, No. 3, at 971 (Jan. 12, 1985) ("*General Explanation*"). The basic question before the court is whether DEFRA Section 641 should be applied retroactively to preclude refund of the estate taxes claimed in *Rosenberg* and *Crocker*. The resolution of this question turns on an analysis of the following issues: (a) whether the language of DEFRA Section 641(b)(2) compels retroactive application of Section 641; (b) whether retroactive application of DEFRA Section 641 violates the due process clause; (c) whether retroactive application of DEFRA Section 641 violates the equal protection clause; and (D) Whether enactment of DEFRA Section 641 violates the separation of powers doctrine.

A. *Whether the language of DEFRA Section 641(b)(2) compels retroactive application of DEFRA Section 641.*

A statute should not be given retroactive application unless its words make that imperative. *Shwab v. Doyle*, 258 U.S. 529, 537 (1922). Pursuant to the unequivocal language of DEFRA Section 641(b)(2) "[t]he provisions of

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[1] Unless otherwise specified, references to *Haffner* are to the district court decision.

[DEFRA] subsection [641] (a) shall . . . apply in the case of any transfer of property . . . if *at any time* there was filed an estate or gift tax return showing such transfer as subject to Federal estate or gift tax." (Emphasis added.) The *General Explanation* emphasizes that "[t]hese provisions apply generally to estates of individuals dying, gifts made, and transfers occurring after June 18, 1984. The provisions also apply to transfers occurring before June 19, 1984, if the transfers previously were reported as subject to Federal transfer." *General Explanation, supra*, at 972. In both *Rosenberg* and *Crocker*, the estate tax returns showed the transfer of the notes to be subject to federal estate tax.

Plaintiffs, relying on *Hasset v. Welch*, 303 U.S. 303 (1928), contend that the "if at any time" language of Section 641(b)(2) does not compel retroactive interpretation of Section 641(b). In *Hasset*, the Supreme Court refused to retroactively apply an estate tax statute, Section 302(c) of the Revenue Act of 1932, which mandated that the decedent's gross estate include interests the decedent transferred "at any time" in certain testamentary transfers. The Court reasoned that the phrase, "at any time"

> appearing in an earlier revenue act, had . . . been held not to render the statute effective upon transfers antedating the passage of the act [footnote omitted] and Congress apparently realized that the expression did not carry the statute back so as to embrace transactions consummated before its passage; for in subsection (h) of section 302 of the Revenue Act of 1926 [footnote omitted] in referring to transactions and interests giving rise to a tax by virtue of preceding subsections, it directed that they should be taxable "whether made, created, arising, existing, exercised,

> or relinquished before or after the enactment of *this Act* [February 26, 1926]." (Footnote omitted) (emphasis in original).

Id. at 308-309.

The Court thus found that "the meaning of the section is not so free from doubt as to preclude inquiry concerning the legislative purpose." *Id.* at 309.

In summarizing it analysis of the legislative history, the Court in *Hasset* stated: "Not only is the legislative history . . . bare of indication of any purpose that it should affect past transfers, but what appears tends to disprove any such thought." *Id.* at 312. Furthermore, the Court noted that the Treasury Department had "consistently ruled" that the statute was to be applied prospectively only. *Id.* at 313.

The *Hasset* case is not controlling. In the cases at bench, there is neither the "doubt" that the Supreme Court found present in *Hasset*; nor a legislative history "bare of indication" of any purpose that the statute should affect past transactions. Rather, the language of DEFRA Section 641(b)(2) clearly mandates that the statute reach past transfers and the *General Explanation* also supports retroactive application. *General Explanation, supra*, at 972.

Plaintiffs in *Rosenberg* contend that if the "at any time" language of DEFRA Section 641(b)(2) was intended to apply retroactively, there would not have been any need to add the "no inference" language in subparagraph (b)(3) which provides that "[n]o inference shall arise from parag[r]aphs (1) and (2) [of Section 641(b)] that any transfer of property (or interest therein) before June 19, 1984 is exempt from Federal estate and gift taxes." A retroactive reading of paragraph (2), plaintiffs argue, "makes paragraph (3) partially inoperative and requires the untenable conclusion that Congress used language idly

in paragraph (3)." Plaintiffs therefore conclude that Section 641(b)(2) should have prospective but not retrospective operation.

This argument lacks merit because it ignores the fact that Section 641(b)(2) does not retroactively apply to all transfers. Rather, Section 641(b)(2) makes the General Rule of Section 641(a) applicable "if at any time *there was filed an estate or gift tax return* showing such transfers as subject to Federal estate or gift tax." (Emphasis added.) Thus, the retroactive provisions of Section 641(b)(2) do not apply where the transfer of property *was not* shown as subject to Federal estate or gift tax on the estate or gift tax return.[2] However, so that Section 641 would not be interpreted as a Congressional recognition that Project Note transfers not shown as subject to estate or gift tax on the return were exempt from estate or gift tax, the "no inference" language of Section 641(b)(3) was added. *General Explanation, supra*, at 972-973.

DEFRA Section 641 contains a "clear, strong and imperative" declaration of retroactivity. *See United States v. Heth*, 3 Cranch, 399, 413, *quoted in Shwab v. Doyle, supra*, 258 U.S. at 535. The legislative history also supports retroactive application of the statute. The court therefore finds that the language of the statute compels retroactive application. Due to this finding, the court now considers whether retroactive application of the statute to the two cases before the court is unconstitutional.

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[2] For example, the provisions of Section 641(b)(2) would not retroactively apply to the transfer in *Haffner* since although the executors listed the Project Notes on the estate tax return, they stated that the Project Notes were not taxable. *Haffner, supra*, 585 F. Supp. at 355.

B. ***Whether retroactive application of DEFRA Section 641 violates the due process clause.***

The starting point for analysis of the due process issue is the Supreme Court's general discussion of due process challenges to retroactive legislation in *Pension Benefit Guaranty Corporation v. R.A. Gray & Company*, ___ U.S. ___, 104 S. Ct. 2709 (1984). In *Gray*, the Court stated:

> It is now well established that legislative Acts adjusting the burdens and benefits of economic life come to the Court with a presumption of constitutionality, and that the burden is on one complaining of a due process violation to establish that the legislature has acted in an arbitrary and irrational way . . . [T]he strong deference accorded legislation in the field of national economic policy is no less applicable when that legislation is applied retroactively. Provided that the retroactive application of a statute is supported by a legitimate legislative purpose furthered by rational means, judgments about the wisdom of such legislation remain within the exclusive province of the legislative and executive branch.

Id. at 2717-18.

There is nothing unusual about retroactive tax laws. *Fein v. United States*, 730 F.2d 1211, 1212 (8th Cir. 1984). In *Welch v. Henry*, 305 U.S. 134 (1938) the Supreme Court stated the underlying rationale for allowing retroactivity of tax laws:

> Taxation is neither a penalty imposed on the taxpayer nor a liability which he assumes by contract. It is but a way of apportioning the cost of government among those who in some measure are privileged to enjoy its benefits and must bear its burdens. Since no citizen enjoys immunity from that burden, its retroactive imposition does not necessarily infringe due process,

> and to challenge the present tax it is not enough to point out that the taxable event, the receipt of income, antedated the statute.

Id. at 146-147.

The retroactive application of a tax statute may still, in a given case, be so unreasonable as to amount to a deprivation of property without due process of law. *Fein v. United States, supra* 730 F.2d at 1212. In determining whether a tax meets this threshold, the Supreme Court has looked to two main considerations: whether the change in the tax law was reasonably foreseeable, *see e.g., United States v. Darusmont*, 449 U.S. 292, 299 (1981) (per curiam) (assuming arguendo relevance of foreseeability of tax change); and whether the change was only a change in tax rate or the imposition of a new tax, *Darusmont, supra*, 449 U.S. at 300; *see also Milliken v. United States*, 283 U.S. 15, 23 (1931). The latter consideration is a based on the former, in that a change in the tax rate is considered by its very nature to be reasonably foreseeable, whereas the imposition of a new tax may not be. *Fein, supra*, 730 F.2d at 1213.

Judge Learned Hand succin[c]tly stated the rationale for the distinction in *Cohan v. Commissioner*, 39 F. 2d 540, 2nd Cir. 1930):

> Nobody has a vested right in the rate of taxation, which may be retroactively changed at the will of Congress at least for periods of less than twelve months; Congress has done so from the outset. . . . The injustice is no greater than if a man chance to make a profitable sale in the months before the general rates are retroactively changed. Such a one may indeed complain that, could he have foreseen the increase, he would have kept the transaction unliquidated, but it will not avail him; he must be prepared for

> such possibilities, the system being already in operation. His is a different case from that of one who, when he takes action, has no reason to suppose that any transactions of the sort will be taxed at all.

Id. at 545.

The parties in the instant actions cite numerous cases that they contend support their respective positions on the due process issue. But the issue seems to turn on the relationship between two cases, *Untermyer v. Anderson*, 276 U.S. 440 (1928) and *Milliken v. United States, supra*.

In *Untermyer*, a gift was made in 1924 while a bill that would tax it was pending before Congress. The statute, enacted a few days later in 1924, created a new tax on inter vivos gifts and applied retroactively. The Court held that retroactive application of this new inter vivos gift tax violated due process. *Id.* at 446.

In *Milliken*, the donor made gifts of corporate stock in December 1916, at which time an estate tax on gifts in contemplation of death was already in effect. In 1918, Congress increased the estate tax rate on such gifts and applied the increased rate to gifts made prior to enactment of the 1918 statute. The donor died in 1920. Inclusion of the gifts in the taxable estate was not challenged; the sole issue was whether the higher rates could properly be applied. The Court held that the retroactive application was constitutional.

The *Milliken* Court distinguished *Untermyer* on the ground of foreseeability of the tax. In *Untermyer* "the nature and amount of the tax burden imposed could not have been understood and foreseen by the taxpayer at the time of the particular voluntary act which was made the occasion of the tax." *Milliken, supra*, at 21. The foreseeability of the tax in *Milliken* was very different:

> Not only was the decedent left in no uncertainty that the gift he was then making was subject to the provisions of the existing statute, but in view of its well

> understood purpose he should be regarded as taking his chances of any increase in the tax burden which might result from carrying out the established policy of taxation under which substitutes for testamentary gifts were classed and taxed with them.

Id. at 23. Generally, the Milliken court held that the constitutionality of retroactivity involved there depended on the nature of the particular tax and upon the gift involved. *Id.* at 21-22.

Numerous courts have narrowly interpreted or questioned *Untermyer* in light of the *Milliken* decision. *Westwick v. Commissioner of Internal Revenue*, 636 F.2d 291, 292 (10th Cir. 1980) (limiting *Untermyer* to "wholly new types of taxes"); *Buttke v. Commissioner of Internal Revenue*, 625 F.2d 202, 203 (8th Cir. 1980), *cert. denied*, 450 U.S. 982 (1981) (reads *Untermyer* to hold that "retroactive application of wholly new tax invalid"); *Sidney v. Commissioner of Internal Revenue*, 273 F.2d 928, 932 (2d Cir. 1960) ("If *Untermyer* remains authority at all, it is so only for the particular situation of a wholly new type of tax there under consideration"); *Shanahan v. United States*, 447 F.2d 1082, 1083 (10th Cir. 1971) ("the force of *Untermyer* has been vitiated by *Milliken*. . . .") These cases indicate that *Milliken* significantly limits *Untermyer*. As Judge Friendly concluded in *Sidney v. Commissioner of Internal Revenue, supra, Untermyer* at best remains good law only for the proposition that a wholly new gift tax cannot be applied retroactively. *Accord Estate of Ceppi, supra,* 698 F.2d at 21.

In the instant cases, the estate tax which DEFRA Section 641 imposed retroactively amounts to [a] wholly new tax. The question before the court in *Haffner* was whether the exemption provided by the Housing Act of 1937 extended to estate taxes. The *Haffner* court answered the question affirmatively, holding that estate taxes were covered

by the exemption. Congress then enacted Section 641 to retroactively remove the exemption which the *Haffner* court ruled existed.

Tax exemptions are "a matter of grace [that] Congress can, of course, disallow . . . as it chooses." *Regan v. Taxation With Representation of Washington*, 461 U.S. 540, 549 (1983) *quoting Commissioner v. Sullivan*, 356 U.S. 27 (1958). However, here, the court finds that the retroactive removal of the exemption from estate tax equals the imposition of a wholly new tax. As such, *Untermyer's* holding that a wholly new estate tax may not be applied retroactively compels the court to find that retroactive application of Section 641 is arbitrary and invalid under the due process clause of the Fifth Amendment. *See Untermyer, supra,* 276 U.S. at 354.

The court emphasizes that the instant cases present far more egregious factual situations than *Untermyer*. In *Untermyer*, the taxpayer made a non-taxable gift twelve days before enactment of a statute which would have made the gift taxable. The government argued that as retroactively applied to the taxpayer's gift, the tax was not unconstitutional because the taxpayer had ample notice of the proposed tax and in all likelihood had made the gift at that particular time to avoid the tax liability. The Supreme Court rejected the argument holding the retroactive application of the tax unconstitutional. The Court stated:

> The mere fact that a gift was made while the bill containing the questioned provisions was in the last state of progress through Congress we think is not enough to differentiate this cause from the former and to relieve the legislation of the arbitrary character there ascribed to it . . . The taxpayer may justly demand to know when and how he becomes liable for taxes – he cannot foresee and ought not to be required to guess the outcome of pending measures.

Id. at 445-6.

Here, the decedents whose estates are the subject of the instant cases, died well before DEFRA was even proposed, much less enacted.[3] Decedents could not have foreseen the enactment, two or three years after their death, of DEFRA's provisions taxing the Project Notes. Further, the government's interpretation of DEFRA would have the untenable result of sanctioning unlimited retroactivity of estate tax statutes.

The court therefore holds that DEFRA's enactment of a wholly new, unforeseeable estate tax of the Project Notes, is arbitrary and unfair. *See Shanahan v. United States, supra,* 447 F.2d at 1082 (retroactive operation is unconstitutional where it is harsh, arbitrary or unfair). As such, retroactive application of DEFRA Section 641 does not withstand plaintiffs' due process attack.

B. ***Whether retroactive application of DEFRA Section 641 violates the equal protection clause.***

Plaintiffs contend that the equal protection component of the Fifth Amendment renders DEFRA Section 641(b)(2) invalid. Section 641(b)(2) only applies retroactively to those estates which filed an estate or gift tax return showing the particular transfer of Project Notes to be subject to Federal estate or gift tax. Decedents' estates fall within this category. Accordingly, plaintiffs argue that this classification violates the equal protection clause.

Generally, statutory classifications are valid if they bear a rational relation to a legitimate governmental purpose. *Regan v. Taxation With Representation of Washington, supra,* 540 U.S. at 547. *Accord Williams v. Vermont,* ____ U.S. ____, 105 S. Ct. 2465 (1985). The Court in *Regan* stated that "[legislatures have especially broad latitude in creating classifications and distinctions in tax statutes,"

[3] Morris Folb died on July 1, 1982. Jules Stein died on April 29, 1981.

Regan, supra, at 547, and then explained its approach to equal protection challenges to tax legislation:

> The broad discretion as to classification possessed by a legislature in the field of taxation has long been recognized. . . . The passage of time has only served to underscore the wisdom of that recognition of the large area of discretion which is needed by a legislature in formulating sound tax policies. Traditionally classification has been a device for fitting tax programs to local needs and usages in order to achieve an equitable distribution of the tax burden. It has, because of this, been pointed out that in taxation, even more than in other fields, legislatures possess the greatest freedom in classification. Since the members of a legislature necessarily enjoy a familiarity with local conditions which this Court cannot have, the presumption of constitutionality can be overcome only by the most explicit demonstration that a classification is a hostile and oppressive discrimination against particular persons and classes. The burden is on the one attacking the legislative arrangement to negative every conceivable basis which might support it.

Regan, supra, 540 U.S. at 547-548, *quoting Madden v. Kentucky,* 309 U.S. 83, 87-88 (1940) (footnotes omitted). Thus, with regard to equal protection challenges to federal tax legislation the standard of review is "minimum rationality." *First National Bank of Oregon v. United States,* 571 F.2d 21, 23 (Ct. Cl. 1978). The Supreme Court has also phrased the test as mandating that a "statutory discrimination will not be set aside if any state of facts reasonably may be conceived to justify it." *McGowen v. Maryland,* 366 U.S. 420, 426 (1961).

The purpose of DEFRA Section 641 was to stop the "rush to market" that Congress envisioned would occur in the wake of the *Haffner* decision. *See General Explana-*

tion, supra, at 971. However, retroactive application of the statute, as required by Section 641(b)(2) results in taxing persons, such as the decedents in the instant cases, who could not have rushed to market after *Haffner*. Plaintiffs correctly contend that retroactive application of DEFRA results in the taxation of the Project Notes held by the estates in the instant cases, yet does not tax the Project Notes held by persons who died the same day as the decedents, whose estates filed a tax return the same day as the plaintiffs, but who chose not to list Project Notes as a taxable asset. Section 641(b)(2) also exonerates the estates of those individuals who died the same day as the decedents, who filed a tax return the same day as the decedents, who (as in *Haffner*), listed the Project Notes as assets of the estate, but who did not pay the tax on the Project Notes.

The court finds that there is absolutely no rational basis for these distinctions. The government argues that it is quite rational for Congress to distinguish between taxpayers who have taken a particular legal position and those, "such as plaintiffs, who have merely joined the bandwagon in the wake of *Haffner* in anticipation of a windfall." This argument lacks merit in that it explicitly assumes that those estates that paid taxes on the Project Notes and then filed for refunds took a different legal position than the estates that did not originally pay the taxes. In our legal system, court decisions may result in "windfalls." To deny persons those windfalls based on speculation about the legal position that they have taken is impermissable.

In *Austin v. United States*, 611 F.2d 117 (5th Cir. 1980), the taxpayer argued that it was a denial of equal protection to require him to pay a minimum tax on a transaction while not requiring all ten equally affected taxpayers to

pay the minimum tax. The court, in rejecting the taxpayers equal protection argument stated:

> It is inherent in any voluntary system of taxation that there will be those who, knowingly or not, fail to file the required returns. The fact that all taxpayers or all areas of the tax law cannot be dealt with by the Internal Revenue Service with equal vigor and that there thus may be some taxpayers who avoid paying the tax cannot serve to release all taxpayers from their obligations . . . The Commissioner's failure to assess deficiences against some taxpayers who owe additional tax does not preclude him from assessing deficiencies against other taxpayers who admitedly owe additional taxes on the same type of income.

Id. at 118-119 (citations omitted).

The instant cases are distinguishable from *Austin*. Here, the issue is not whether the Commissioner may chose [*sic*] to audit some taxpayers and not others. Rather, the issue is whether Congress may retroactively pass a law that discriminates against taxpayers who paid a tax and filed for a refund in favor of those who chose not to pay the tax. The court holds that Congress may not as there is no rational basis for such a distinction. The government's assertion that Congress may make such a distinction based on a taxpayer's expectations is without support.

While it may under certain circumstances be reasonable and prudent for Congress to adopt a retroactive tax measure designed to eliminate an existing exemption, DEFRA Section 641(b)(2) creates a classification scheme that is arbitrary and capricious. The court thus holds that Section 641(b)(2) violates the equal protection clause.[4]

---

[4] Plaintiffs in *Rosenberg* contend that retroactive application of Section 641(b)(2) violates the separation of powers doctrine. The court finds that this argument lacks merit. Since the court has held that Sec-

II. WHETHER THE PROJECT NOTES ARE EXEMPT FROM FEDERAL ESTATE TAXES UNDER SECTION 11(B) OF THE HOUSING ACT OF 1937, 42 U.S.C. SECTION 1437i(b).

For the reasons found persuasive in *Haffner v. United States*, 585 F.Supp. 354 (N.D. Ill. 1984), *aff'd*, 757 F.2d 920 (7th Cir. 1985), the court holds that the Project Notes are exempt from federal estate taxes under section 11(b) of the Housing Act of 1937, 42 U.S.C. Section 1437i(b). In so holding, the court adopts the reasoning and analysis of the *Haffner* district court's opinion.

CONCLUSION

The court, having considered the parties' papers and arguments, and having further considered the law of and record of these cases in their entirety, finding that there are no genuine issues of material fact in dispute and that plaintiffs in both No. CV 85-3465 and No. CV 85-7614 are entitled to summary judgment as a matter of law against defendant, now therefore.

HEREBY GRANTS plaintiffs' motions for summary judgment and DENIES defendant's cross motion for summary judgment.

DATED: Oct. 20, 1986

/s/ CONSUELO B. MARSHALL
Consuelo B. Marshall, *Judge*
United States District Court

---

tion 641(b)(2) does not survive due process and equal protection challenges, further discussion of the separation of powers argument is unnecessary.

APPENDIX B

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

CASE NO. CV 85-7614 CBM

CROCKER NATIONAL BANK, A NATIONAL BANKING ASSOCIATION, LEW R. WASSERMAN, AND RUTH S. COGAN, AS EXECUTORS OF THE WILL OF JULES C. STEIN, DECEASED, PLAINTIFFS,

v.

UNITED STATES OF AMERICA, DEFENDANT.

Oct. 20, 1986

JUDGMENT

This matter is before the court on the parties' cross motions for summary judgment. Based upon the Consolidated Memorandum Opinion filed herewith.

IT IS HEREBY ORDERED, ADJUDGED AND DECREED that plaintiffs' motion for summary judgment is GRANTED.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that defendant's motion for summary judgment is DENIED.

DATED: Oct. 20, 1986

/s/ CONSUELO B. MARSHALL
Consuelo B. Marshall, *Judge*
United States District Court

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

CASE NO. CV 85-3465 CBM

HARRY ROSENBERG AND ARTHUR ROSEN, CO-TRUSTEES OF THE MORRIS AND TILLIE FOLB TRUST, FBO TILLIE FOLB, PLAINTIFFS,

v.

UNITED STATES OF AMERICA, DEFENDANT.

Oct. 20, 1986

JUDGMENT

This matter is before the court on the parties' cross motions for summary judgment. Based upon the Consolidated Memorandum Opinion filed herewith.

IT IS HEREBY ORDERED, ADJUDGED AND DECREED that plaintiffs' motion for summary judgment is GRANTED.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that defendant's motion for summary judgment is DENIED.

DATED: Oct. 20, 1986

/s/ CONSUELO B. MARSHALL
Consuelo B. Marshall, *Judge*
United States District Court

APPENDIX C

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

CASE NO. CV 85-7614 CBM(JRx)

CROCKER NATIONAL BANK, A NATIONAL BANKING ASSOCIATION, LEW R. WASSERMAN, AND RUTH S. COGAN, AS EXECUTORS OF THE WILL OF JULES C. STEIN, DECEASED, PLAINTIFFS,

v.

UNITED STATES OF AMERICA, DEFENDANT.

[Filed NOV. 19, 1986]

NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES

PLEASE TAKE NOTICE that the United States of America hereby appeals to the Supreme Court of the United States from the Judgment entered in this action on October 23, 1986, by the Honorable Consuelo B. Marshall, United States District Judge, in the United States District Court for the Central District of California.

This appeal is taken under 28 U.S.C. § 1252.
DATED: November 18, 1986

Respectfully submitted,

ROBERT C. BONNER
United States Attorney
CHARLES H. MAGNUSON
Assistant United States Attorney
Chief, Tax Division

/s/ JEFFREY G. VARGA

Jeffrey G. Varga
Assistant United States Attorney
Attorneys for United States of America

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

CASE NO. CV 85-3465 CBM(JRx)

HARRY ROSENBERG AND ARTHUR ROSEN, CO-TRUSTEES OF THE MORRIS AND TILLIE FOLB TRUST, FBO TILLIE FOLB, PLAINTIFFS,

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ROBERT C. BONNER
United States Attorney
CHARLES H. MAGNUSON
Assistant United States Attorney
Chief, Tax Division

/s/ JEFFREY G. VARGA

Jeffrey G. Varga
Assistant United States Attorney
Attorneys for United States of America

APPENDIX D

The Fifth Amendment to the United States Constitution provides in pertinent part:

> No person shall * * * be deprived of life, liberty, or property, without due process of law; * * *

Section 641 of the Deficit Reduction Act of 1984, Pub. L. No. 98-369, 98 Stat. 494 provides:

CLARIFICATION OF TREATMENT OF CERTAIN EXEMPTIONS FOR PURPOSES OF THE FEDERAL ESTATE AND GIFT TAXES.

(a) *General Rule.*—Nothing in any provision of law exempting any property (or interest therein) from taxation shall exempt the transfer of such property (or interest therein) from Federal estate, gift, and generation-skipping transfer taxes. In the case of any provision of law enacted after the date of the enactment of this Act, such provision shall not be treated as exempting the transfer of property from Federal estate, gift, and generation-skipping transfer taxes unless it refers to the appropriate provisions of the Internal Revenue Code of 1954.

(b) *Effective Date.*—

"(1) *In General.*—The provisions of subsection (a) shall apply to the estates of decedents dying, gifts made, and transfers made on or after June 19, 1984.

"(2) *Treatment of certain transfers treated as taxable.*—The provisions of subsection (a) shall also apply in the case of any transfer of property (or interest therein) if at any time there was filed an estate or gift tax return showing such transfer as subject to Federal estate or gift tax.

"(3) *No inference.*—No inference shall arise from paragraphs (1) and (2) that any transfer of property (or interest therein) before June 19, 1984, is exempt from Federal estate and gift taxes.

The United States Housing Act of 1937, ch. 896, 50 Stat. 888 *et seq.* provides:

SEC. 1. It is hereby declared to be the policy of the United States to promote the general welfare of the Nation by employing its funds and credit, as provided in this Act, to assist the several States and their political subdivisions to alleviate present and recurring unemployment and to remedy the unsafe and insanitary housing conditions and the acute shortage of decent, safe, and sanitary dwellings for families of low income, in rural or urban communities, that are injurious to the health, safety, and morals of the citizens of the Nation.

SEC. 2. When used in this Act—

* * * * *

(11) The term "public housing agency" means any State, county, municipality, or other governmental entity or public body (excluding the Authority), which is authorized to engage in the development or administration of low-rent housing or slum clearance.

* * * * *

SEC. 3. (a) There is hereby created in the Department of the Interior and under the general supervision of the Secretary thereof a body corporate of perpetual duration to be known as the United States Housing Authority, which shall be an agency and instrumentality of the United States.

* * * * *

SEC. 5.

* * * * *

(e) The Authority, including but not limited to its franchise, capital, reserves, surplus, loans, income, assets, and property of any kind, shall be exempt from all taxation now or hereafter imposed by the United States or by any State, county, municipality, or local taxing authority. Obligations, including interest thereon, issued by public housing agencies in connection with low-rent housing or

slum-clearance projects, and the income derived by such agencies from such projects, shall be exempt from all taxation now or hereafter imposed by the United States.

SEC. 20. (a) The Authority is authorized to issue obligations, in the form of notes, bonds, or otherwise, which it may sell to obtain funds for the purposes of this Act. The Authority may issue such obligations in an amount not to exceed $100,000,000 on or after the date of enactment of this Act, an additional amount not to exceed $200,000,000 on or after July 1, 1938, and an additional amount not to exceed $200,000,000 on or after July 1, 1939. Such obligations shall be in such forms and denominations, mature within such periods not exceeding sixty years from date of issue, bear such rates of interest not exceeding 4 per centum per annum, be subject to such terms and conditions, and be issued in such manner and sold at such prices as may be prescribed by the Authority, with the approval of the Secretary of the Treasury.

(b) Such obligations shall be exempt, both as to principal and interest, from all taxation (except surtaxes, estate, inheritance, and gift taxes) now or hereafter imposed by the United States or by any State, county, municipality, or local taxing authority.

* * * * *

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MOTION

No. 86-1521

Supreme Court, U.S.
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In the Supreme Court
OF THE
United States

OCTOBER TERM, 1986

UNITED STATES OF AMERICA,
Appellant,

v.

CROCKER NATIONAL BANK, et al.
Appellees,

UNITED STATES OF AMERICA,
Appellant,

v.

HARRY ROSENBERG AND ARTHUR ROSEN, Etc.
Appellees.

On Appeal from the United States District Court for the Central District of California

MEMORANDUM OF APPELLEES CROCKER NATIONAL BANK, ET AL.

ROBERT H. ROTSTEIN
(Counsel of Record)
KATHERINE T. PRATT
THOMAS P. SMITH
ROSENFELD, MEYER & SUSMAN
9601 Wilshire Boulevard, Suite 444
Beverly Hills, California 90210
(213) 858-7700
Attorneys for Appellees, Crocker National Bank, Lew R. Wasserman, and Ruth S. Cogan, as Executors of the Will of Jules C. Stein

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No. 86-1521

In the Supreme Court
OF THE
United States

OCTOBER TERM, 1986

UNITED STATES OF AMERICA,
Appellant,

v.

CROCKER NATIONAL BANK, et al.
Appellees,

UNITED STATES OF AMERICA,
Appellant,

v.

HARRY ROSENBERG and ARTHUR ROSEN, Etc.
Appellees.

On Appeal from the United States District Court for the Central District of California

MEMORANDUM OF APPELLEES CROCKER NATIONAL BANK, ET AL.

I.

INTRODUCTION

Although Appellees (Crocker National Bank, Lew R. Wasserman, and Ruth S. Cogan, as Executors of the Will of Jules C. Stein ("Stein")) do not move to affirm the judgment of the district court or to dismiss the appeal, they file this memorandum to state their position concerning the issues raised in the jurisdictional statement

("JS") of Appellant United States of America (the "Government"). The Government appeals pursuant to 28 U.S.C. § 1252 from the judgment of the United States District Court for the Central District of California granting Appellees' motion for summary judgment. The district court held that Appellees were entitled to a refund of estate taxes in the amount of $1,320,097. The district court so held on the grounds that certain short-term obligations of public housing agencies ("Project Notes") issued pursuant to the Housing Act of 1937, Pub. L. 75-412 (1937) (the "1937 Act") and included in Stein's gross estate were exempt from federal estate taxation. The district court also held that retroactive application of § 641 of the Deficit Deduction Act of 1984, Pub. L. 98-369 (1984) ("DEFRA"), violates the due process clause and equal protection component of the Fifth Amendment. The Government filed a notice of appeal to this Court on November 19, 1986 and filed its jurisdictional statement on March 19, 1987. Appellees received a copy of the jurisdictional statement on March 24, 1987.

Stein died on April 29, 1981. On January 29, 1982, Appellees filed a federal estate tax return for Stein's estate. The return included Project Notes that Stein owned at the time of his death. The 1937 Act had provided that these notes were exempt from estate tax. 1937 Act § 11(b) (formerly § 5(e)). Nevertheless, Appellees included the Project Notes on the return under the mandate of Revenue Ruling 81-63, 1981-1 C.B. 455 (1981), in which the Service had erroneously ruled that Project Notes were subject to federal estate tax. On April 25, 1984, the court in *Haffner v. United States*, 585 F. Supp. 354 (N.D. Ill. 1984), held that such Project Notes are exempt from federal estate tax.

On June 29, 1984, Appellees filed a claim for refund of $1,320,097, the amount of estate tax attributable to including the Project Notes in the estate, plus interest. After the Internal Revenue Service ("IRS") denied the claim for refund, Appellees brought suit in the district court for refund of the estate tax overpayment. The Government filed a motion to dismiss pursuant to Federal Rule of Civil Procedure 12(b)(6), asserting that *Haffner* was wrongly decided and that, in any event, under § 641(b)(2) of DEFRA Appellees' inclusion of the Project Notes on the tax return retroactively subjected the transfer of the Project Notes to taxation. After hearing the motion to dismiss, the district court allowed the Government and Appellees to file cross-motions for summary judgment.

The district court granted Appellees' motion for summary judgment, holding that, under the reasoning and analysis of the district court in *Haffner v. United States*, 585 F. Supp. 354 (N.D. Ill. 1984), *aff'd*, 757 F.2d 920 (7th Cir. 1985), Stein's Project Notes were exempt from federal estate taxation under §11(b) of the 1937 Act. The district court in *Haffner* concluded that both the wording of §§ 5(e) and 20(b) of the 1937 Act and the legislative history of the 1937 Act demonstrate that Congress intended that Project Notes be exempt from federal estate tax.

The district court also held that retroactive application of DEFRA § 641 violates the due process and equal protection clauses of the Fifth Amendment. In finding a violation of due process, the district court relied on *United States v. Darusmont*, 449 U.S. 292 (1981) (per curiam) and *Untermyer v. Anderson*, 276 U.S. 440 (1928). In finding an equal protection violation, the district court held that DEFRA § 641(b)(2) was intended to avoid a post-*Haffner* "rush to the market" to purchase Project

Notes, and that, in light of this purpose, there was no rational basis for distinguishing between those estates that had listed Project Notes as assets of the estate and those estates that had not.

II.

BOTH THE STATUTORY LANGUAGE AND THE LEGISLATIVE HISTORY OF THE 1937 ACT DEMONSTRATE THAT PROJECT NOTES WERE EXEMPT FROM ESTATE TAXATION

A. The District Court Properly Followed the *Haffner* Decision

The district court properly relied on the *Haffner* decision holding Stein's Project Notes exempt from estate tax. First, the 1937 Act on its face exempts Project Notes from estate taxation. Section 5(e) of the 1937 Act exempted Project Notes — like Stein's — from "all taxation." In contrast, § 20(b) of the Act exempts obligations of the federal housing authorities from "all taxation (*except* surtaxes, *estate,* inheritance and gift taxes)" (emphasis added). As a matter of simple statutory construction, Congress' explicit exclusion of estate tax from § 20(b), but not from § 5(e), demonstrates that Congress intended that the blanket exemption found in § 5(e) include estate tax. *See Jandorf's Estate v. Commissioner of Internal Revenue,* 171 F.2d 464, 466 (2nd Cir. 1948).[1]

Second, the legislative history of the 1937 Act shows that Congress intended to exempt Project Notes from estate tax. Congress passed the 1937 Act after three

[1]In light of the clear indication that Congress intended that the exemption from "all taxation" found in § 5(e) include an exemption from estate tax, *United States Trust Company v. Helvering,* 307 U.S. 57 (1939) and *Murdock v. Ward,* 178 U.S. 139 (1900), cited by the Government, are inapposite.

years' careful consideration of various bills that were designed to help ameliorate the acute housing problems that existed in the United States at that time. The Senators most knowledgeable about the bill that ultimately became the 1937 Act (S. 1685, "the Wagner Bill") were Senator David I. Walsh, Chairman of the Senate Committee on Education and Labor (the "Senate Committee") — who presided over the Senate Hearings on the various housing bills under consideration[2] — and Senator Robert F. Wagner, who introduced the Wagner Bill. 80 CONG. REC. 9558 (1936).[3]

On August 3, Senator Walsh, for the record, described the Wagner Bill in detail, adding that his views were those of the Senate Committee that had reviewed the Bill. Senator Walsh explained to Congress:

> "Obligations, including interest thereon, issued by public housing agencies, and income derived by such agencies, on such projects are to be exempt from all taxation now or hereafter imposed by the United States. In other words, the Bill gives the public housing agencies the right to issue tax-exempt bonds, which means they are free from income tax, surtax, *estate,* gift, and inheritance taxes."

81 CONG. REC. 8085 (1937) (emphasis added). As the district court in *Haffner* noted, Senator Walsh's words are "straightforward, unambiguous and emphatic." 585 F.Supp. at 359. Although Senator Wagner was present for Senator Walsh's explanation of the Bill and on several occasions clarified or corrected Senator Walsh's remarks,

[2]As a member of the Senate Finance Committee for 16 years, Senator Walsh was also knowledgeable about tax matters in general. *Congressional Directories,* 1922-1937.

[3]The Senate debated the Wagner Bill on August 2, 3 and 4, 1937. 81 CONG. REC. 7967 *et seq.*

he expressed no disagreement (indeed, made no comments at all) about Senator Walsh's statement quoted above. 81 CONG. REC. 8080, 8081 (1937).

Other legislative history supports the district court's holding that the 1937 Act exempted Project Notes from estate tax. During the 1937 Committee Hearings, Secretary of the Interior Harold L. Ickes proposed certain amendments to the Wagner Bill (the version of the bill proposed by Ickes is hereinafter referred to as the "Ickes version"). The § 20(b) exemption in the Ickes version was identical to the § 20(b) exemption in the Wagner Bill. However, § 5(e) of the Ickes version would have exempted obligations of local public housing agencies from "all taxation *(except estate, inheritance and gift taxes)* now or hereafter imposed by the United States" (emphasis added). SENATE COMMITTEE ON EDUCATION AND LABOR HEARINGS, April 14, 1937, 59, 64. In other words, unlike the 1937 Act, the Ickes version expressly excluded estate tax from *both* §§ 5(e) and 20(b), not just 20(b). Significantly, the Senate Committee rejected the Ickes version. This rejection constitutes further compelling evidence that, as the district court found, § 5(e) (now § 11(b)) of the 1937 Act exempts Project Notes from estate tax.

Although the Government contends otherwise (JS at 11), sound policy reasons justified Congress' decision to exempt Project Notes from federal estate tax. The legislative history of the several housing bills introduced in the 1930's indicates that Congress wished to establish a decentralized housing system, one that would allow the states to assume greater responsibility for remedying housing problems. Up to that time, the federal government had assumed that responsibility. S. REP. NO. 1545, 75th Cong. 1st Sess. 2; SENATE COMMITTEE ON EDUCATION AND LABOR HEARINGS, April 20-29, 1936, 18. However, because of the depression, many states and

municipalities during the 1930's were facing serious financial problems, and some were even bankrupt. SENATE COMMITTEE ON EDUCATION AND LABOR HEARINGS, April 20-29, 1936, 73. In addition, because the public housing agencies were new, it was unclear whether an adequate market for the Project Notes would develop. Congress thus provided in the 1937 Act "[e]very inducement" for investment in Project Notes. *Id.* at 17. Exempting the public housing Project Notes from estate taxation would thus help the distressed municipalities raise revenues for public housing (in that way relieving the federal government of that role) by making the Project Notes more marketable. *See* HOUSE COMMITTEE ON BANKING AND CURRENCY HEARINGS, August 3-6, 1937, 199.

B. The Government's Criticisms of *Haffner* Lack Validity

The Government characterizes the legislative history of the 1937 Act as "flimsy" (JS at 10), citing Judge Posner's dissent from the Court of Appeals decision in *Haffner*. However, the *Haffner* dissent apparently began, not with an analysis into the statutory language and the legislative history of the 1937 Act, but with the conclusion that it wanted to reach — namely, that Project Notes were subject to estate tax. In an archetypical case of *post hoc* rationalization, the dissent then worked backwards, crafting theories purporting to explain away the clear statutory language and legislative history.

The *Haffner* dissent first attempted to reconcile the difference between §§ 5(e) and 20(b), positing that one could draw no inference from § 20(b) about whether the § 5(e) exemption was intended to include an exemption from estate tax, since the drafters of the 1937 Act included the § 20(b) parenthetical to except *surtax* from the exemption, and merely used explicit language to exclude estate and gift taxes from the § 20(b) exemption

"out of an abundance of caution." 757 F.2d at 922. This explanation is illogical: cautious drafters also intending to exclude estate and gift taxes from the § 5(e) exemption would undoubtedly have done so explicitly — as they did in § 20(b).[4] Put differently, there is no reason to assume, as the *Haffner* dissent did, that the drafters were careful with § 20(b), but sloppy with § 5(e). Instead, it makes more sense to conclude that, consistent with principals of statutory construction, the portion of the § 20(b) parenthetical excepting estate tax from the 20(b) exemption is not surplusage, but reflects a conscious decision to except estate taxes from the § 20(b) exemption and to include estate taxes in the § 5(e) exemption. *See* N. Singer, *Sutherland Statutory Construction*, Vol. 2A §§ 46.05, 46.06 (Sands, 4th Ed. 1984).

The *Haffner* dissent also tried to diminish the importance of Senator Walsh's statement, speculating that Senator Walsh misspoke and that Senator Wagner failed to correct Senator Walsh because of inadvertence. However, that speculation underestimates both Senator Walsh's knowledge and experience (discussed above) and Senator Wagner's concern about the 1937 Act.[5] It is thus extremely unlikely that Senator Walsh would have mis-

[4]Indeed, if the drafters of the 1937 Act had intended to except estate and gift taxes from the § 5(e) exemption, they could have easily copied either § 20(b) or § 5(e) of the Ickes version. They did neither.

[5]Senator Wagner believed that solving the acute public housing crisis that existed at the time was of paramount importance. *See, e.g.*, Comments of Senator Wagner in Speech Delivered at Yorkville, New York, on July 16, 1937, found in *Collected Papers of Senator Robert F. Wagner*, Vol. III, Sec. 3, No. 52, preserved at Georgetown University, Washington, D.C., reprinted in T. McDonnell, *The Wagner Housing Act*, 19 (1957). Senator Wagner attended the Committee Hearings on the various housing bills, and even during Committee Hearings that lasted several days, was quick to interrupt witnesses or other senators to offer clarification or correction. *See, e.g.*, SENATE COMMITTEE ON EDUCATION AND LABOR HEARINGS, April 20-29, 1936, 195-201.

spoken or that Senator Wagner would, as the *Haffner* dissent hypothesized, have "nodded" during Senator Walsh's explanation of Senator Wagner's bill, especially since Senator Walsh's statement was for the record.[6]

Likewise, the *Haffner* dissent attempted to reconcile its position with the Senate Committee's rejection of the Ickes version (which, as noted above, *would* have explicitly excepted estate tax from the § 5(e) exemption). The dissent found the rejection of the Ickes version insignificant on the grounds that there was no evidence that the Ickes version was rejected specifically because it failed to exempt Project Notes from estate tax. In so concluding, the *Haffner* dissent missed the point: the rejection of the Ickes version is important because § 5(e) of that bill provided a perfect blueprint to accomplish explicitly what the Government now argues Congress meant to accomplish implicitly. Thus, it is most reasonable to conclude that, by adopting language that differs from the Ickes version, the cautious drafters of the 1937 Act intended the § 5(e) exemption to include exemption from estate tax.

In support of its position, the Government also asserts (JS at 11) that granting an exemption from estate taxation under § 5(e) would be "difficult to justify from the standpoint of tax policy." But tax policy often gives way to other policies, and here, the Government fails to consider other countervailing policies that existed in 1937. *See* 1937 Act § 1. By 1937, the housing shortage in the United States had reached crisis proportions. As indicated above, Senator Wagner viewed the resolution of the

[6]Indeed, Senator Walsh's elucidation of the § 5(e) exemption is consistent with the Education and Labor Committee's printed summary of the Bill. 81 CONG. REC. 8087, 8088 (1937).

housing problem as *the* paramount issue to be resolved by the United Stated Government at that time. In light of the critical need to resolve the housing crisis that existed at that time, a blanket § 5(e) exemption is easy to justify.

In sum, both the explicit wording of §§ 5(e) and 20(b) of the 1937 Act and the legislative history of the Housing Act of 1937 provide a clear indication that Congress intended that Project Notes be exempt from estate tax. The district court, relying on *Haffner*, properly held that Stein's Project Notes were exempt from estate taxation.[7]

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[7]The Government states (JS at 8, n.3) that it is informed by the IRS that there are currently pending, administratively or in court, approximately 160 estate and gift tax cases involving over $260 million in Project Notes. However, the Government also indicates (JS at 11, 12, n.6) that "a large portion" of the $260 million in Project Notes involved in pending litigation are held by estates "to which DEFRA does not apply." The Government does not disclose the amount of Project Notes involved in DEFRA § 641(b)(2) cases. In addition, the tax that would be due on the total amount of these Project Notes if they were held to be subject to estate tax would be only a fraction of the value of the Project Notes. The highest marginal rate for estate tax was, until recently, 55 percent and is currently 38.5 percent. 26 U.S.C. § 1. Moreover, estates pay tax only on amounts in excess of what is commonly referred to as the exemption equivalent, the maximum amount of which is currently $600,000. 26 U.S.C. § 2010. Further, the *total* estate tax and gift tax collected in 1985 from all sources (of which a tax on Project Notes would form a miniscule part) was $6.4 billion, which amounts to less that one percent of the total taxes collected in 1985. *Budget of the United States Government — Fiscal Year 1987*, prepared by the Executive Office of the President and the Office of Management and Budget, submitted to Congress on February 5, 1986. The ramifications of the district court's holding are thus not as the Government characterizes them.

III.

THE DISTRICT COURT PROPERLY HELD THAT DEFRA § 641(b)(2) IS UNCONSTITUTIONAL AS RETROACTIVELY APPLIED TO THE STEIN ESTATE

The district court held that retroactive application of DEFRA § 641(b)(2) to the Stein estate violates both the due process clause and the equal protection component of the Fifth Amendment. In so holding, the district court recognized the unique and far-reaching retroactivity of the Government's construction of DEFRA § 641(b)(2) — a form of retroactivity virtually unparalleled in the history of retroactive tax statutes.

In *Welch v. Henry*, 305 U.S. 134, 147 (1938), this Court established guidelines for determining whether a retroactive taxing statute violates the due process clause:

> "In each case it is necessary to consider the nature of the tax and the circumstances in which it is laid before it can be said that its retroactive application is so harsh and oppressive as to transgress the constitutional limitation."

In deciding whether a retroactive tax is impermissibly harsh and oppressive, the courts have inquired into several factors.

First, where, as here, the Government seeks to impose a retroactive *estate* tax on transfers at death, the due process implications are greater, because retroactively applying estate and gift tax statutes is less constitutionally justified than retroactively applying other tax laws, *e. g.*, income tax laws. *See United States v. Darusmont*, 449 U.S. 296, 299 (1981); *Welch v. Henry*, 305 U.S. 134, at 147, 148 (1938). This distinction recognizes that, before death, an individual may dispose of property and make other relevant decisions in reliance on the existing estate and gift

tax laws; retroactivity may impact on these decisions. Thus, had a decedent known that a tax statute would be applied retroactively, he may have treated his estate differently. By contrast, it is unlikely that a person would have tried to earn less income had he known of a retroactive income tax. *Welch v. Henry*, 305 U.S. at 148.

Second, it is true that tax legislation is often retroactive. *United States v. Darusmont*, 449 U.S. at 297. But the retroactive feature of such legislation "has been confined to short and limited periods." *Id.*

Third, as the district court correctly noted, in deciding whether a retroactive tax statute violates the due process clause, courts must consider whether a change in the tax law was reasonably foreseeable and whether the change was only a change in the rate of tax or constituted the imposition of a new tax. *Id.* at 299.[8] Finally, it is relevant whether the taxpayer had actual or constructive notice of the retroactive statute. *United States v. Hemme*, 106 S. Ct. 2071 (1986).

The district court properly applied these factors in finding that DEFRA § 641(b)(2) violated the due process clause. First, this case involves retroactive application of an estate tax. Second, DEFRA § 641(b)(2), as interpreted by the Government to have unlimited retroactivity, hardly constitutes a short and limited period of retroactivity. On the contrary, in the present case, the Government seeks to apply a statute proposed in May or June of 1984 and enacted in July of 1984 to a transfer by death occurring in April 1981, more than three years earlier. This purported period of retroactivity goes beyond the "short period" of retroactivity permitted by some cases,[9] and distinguishes this case from the majority of cases in which retroactive application of a tax statute is upheld.[10]

Third, Stein could not, in 1981, have foreseen that DEFRA § 641, which for the first time subjected Project Notes to estate tax, would be enacted three years after his death. Stein's reasonable expectation was that the Project Notes would be exempt from estate tax. He purchased the Project Notes after the Government had issued unqualified offering circulars, first in 1977 and again in 1980, stating that the Project Notes were exempt from all taxation. "Short-Term Tax-Exempt Project Notes," *Department of Housing and Urban Development Offering Circulars* (March 1977 and August 1980). It was not until 1981, the year of Stein's death, that the Government first publicly ruled that Project Notes were subject to federal estate tax. Revenue Ruling 81-83, 1981-1 C.B. 455. Finally, Stein certainly had no notice in 1981 of Congress' consideration of DEFRA § 641(b)(2), which was first proposed in mid-1984.

In addition, as the district court found, imposition of a tax on Project Notes under DEFRA § 641 was a "wholly new tax." Quite simply, since 1937, Project Notes had been a species of property that had been subject to no tax whatsoever. DEFRA § 641 for the first time subjected that property to tax. This novel, unforeseeable taxation of

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[8]The district court properly noted that the question whether a change involves the imposition of a new tax is just another way of approaching the issue of foreseeability of the change. JS at 10a, *citing Fein v. United States*, 730 F.2d 1211 at 1212 (8th Cir. 1984).

[9]Indeed, in connection with a retroactive gift tax, even such a short period was held to be impermissible in *Untermeyer v. Anderson*, 276 U.S. 440 (1928).

[10]In fact, the district court noted that "the government's interpretation of DEFRA would have the untenable result of sanctioning unlimited retroactivity of estate tax statutes." JS at 14a.

Project Notes under § 641 was hardly the equivalent of a change in a tax rate like that in, for example, *Darusmont*.[11]

Recognizing that a decedent like Stein could not have foreseen a retroactive statute like DEFRA § 641(b)(2), the Government attempts to shift the focus from the decedent's reasonable expectations to the executors' conduct in filing the estate tax return. In so doing, the Government fails to acknowledge that it is the decedent who, in planning his estate, relies on assumptions about the tax laws. Moreover, even if the executors' conduct were germane, the mere act of Stein's executors in listing the Project Notes on the estate tax return would not save DEFRA § 641(b)(2) from its constitutional infirmities. Contrary to the Government's assertion, listing the Project Notes on the return does not mean that an executor believed that the Project Notes were taxable. Rather, such an executor may very well have included the Project Notes on the return in compliance with his fiduciary duties, following Revenue Ruling 81-63 and relying on the right to obtain a refund pursuant to 26 U.S.C. §§ 6511 and 7422(a).

The Government also states (JS at 15) that "while it is true that the instant decedents, prior to their death could not have foreseen the enactment of DEFRA, it is also evident that they did not foresee the opinion in *Haffner* either — their executors, after all, included the Project Notes in their taxable estates". This argument has three

[11]The Government apparently equates "a wholly new tax" with a general category of tax (*e.g.*, income, estate, gift) heretofore never imposed, and argues that only those types of new taxes may violate due process. Yet the Government fails to explain why this is so. In fact, the salient issues go to foreseeability and fairness; it is patent that it may be just as unfair to a taxpayer to unexpectedly subject a heretofore tax-free species of property to a retroactive tax as it is to impose retroactively a new category of tax on him or his property.

flaws. First, it again incorrectly equates the reporting stance taken by the executors with the reasonable expectations of the decedent. Second, it assumes that no one before *Haffner* — including Stein — believed Project Notes to be exempt from estate tax. This assumption rests on a false premise; in fact, it is reasonable to assume that Stein, having read the Government's own offering circulars promising to exempt the Project Notes from all present and future taxation, would have expected that the Notes would always remain exempt from estate tax. *Haffner* did not change the law; it merely confirmed what the law had been for 47 years. Third, the Government's statement incorrectly assumes that the executors listed the Project Notes because of a belief in their taxability, rather than in the exercise of prudence and under the compulsion of the erroneous Revenue Ruling.

The district court also found that § 641(b)(2) violates the equal protection component of the Fifth Amendment by making a tax classification with no rational relation to a legitimate governmental purpose. *See Williams v. Vermont*, 472 U.S. 14 (1985). The district court noted that the purpose of § 641 was to avoid, in the wake of the *Haffner* decision, a "rush to the market" by taxpayers who would buy Project Notes in order to avoid estate taxation. The district court correctly pointed out that the Government's interpretation of § 641(b)(2) would impose tax on taxpayers who, like Stein, could not have rushed to the market after *Haffner*, but would reward those who rushed to the market after *Haffner* and failed to list Project Notes on their returns at all.

Further, the district court emphasized that the Government would tax Stein's estate, but would refrain from taxing Project Notes held by persons who died the same day as Stein; who filed a tax return the same day as Stein's executors; but who chose not to list Project Notes

as taxable assets. The Government would also exonerate the estates of those individuals who filed a tax return the same day as Stein; who (as in *Haffner*) listed the Project Notes as assets of the estate; but who did not pay the tax on the Project Notes. Finally — and perhaps most astonishingly — the Government would excuse the estates of decedents who died the same as Stein but who fraudulently failed to file an estate tax return at all.

There is no rational basis for these distinctions. The Government argues that the statute targets only taxpayers who listed the Project Notes as taxable in order to "eliminate any possible perception of unfairness." JS at 15. The Government's position is that Congress thought it would be unfair to impose retroactive estate tax except where the filing of a return "manifested a belief" that the Project Notes were taxable. JS at 15. Yet once again, the Government confuses the expectation of the individual who acquired and held the Project Notes with the reporting behavior of the executors. Moreover, the Government's argument provides no rational basis for the distinction in any event: again, a conservative executor in 1982, cognizant of Revenue Ruling 81-63, may have believed that the Project Notes were exempt from taxation, yet in the exercise of prudence listed the Project Notes and paid the tax, intending to file a claim for refund. At the same time, an executor in 1982 may have believed Revenue Ruling 81-63 to be correct and thus have considered Project Notes taxable, but may have fraudulently chosen not to file an estate tax return. Yet under the Government's approach, the former estate would be retroactively taxed on Project Notes, while the latter would not, even though the executors' expectations were the exact opposite. This distinction is hardly rational.

Ironically, this classification, which the Government asserts was designed to eliminate unfairness, penalizes

forthright taxpayers like Appellees and rewards aggressive (and even dishonest) taxpayers who rushed to the market after *Haffner;* who aggressively failed to list Project Notes on their estate tax returns; or who failed to pay a tax at all. Indeed, the only taxpayers that the Government would tax retroactively are those who were conservative, honest, and could not, by dint of the time of their death, have rushed to the market. By no stretch of the imagination could this be a rational distinction. Section 641(b)(2), as interpreted by the Government, violates the equal protection component clause of the Fifth Amendment.

IV.

UNDER THE MOST REASONABLE INTERPRETATION OF THE STATUTE, § 641(b)(2) DOES NOT APPLY TO THE DECEDENT'S ESTATE

Appellees contended below that as a matter of statutory construction § 641(b)(2) has no applicability to Stein's estate. Although the district court did not adopt defendant's contention, this appeal brings the entire case before the Court. *United States v. Locke,* 471 U.S. 84, 92 (1985). Thus, in accordance with the policy of ascertaining whether the construction of a statute is fairly possible on which constitutional questions may be avoided before passing on these questions, the Court may affirm the decision below by finding that under its correct construction the statute has limited rather than unlimited retroactive application. *Ashwander v. Tennessee Valley Authority,* 297 U.S. 288, 348 (1936) (Brandeis, J., concurring). An interpretation under which a statute has only limited retroactivity must be favored, since a statute should not be given retroactive effect unless its words make that imperative. *Schwab v. Doyle,* 258 U.S. 529, 537 (1922). Moreover, just because a statute applies to events occur-

ring "at any time" does not mean the statute has unlimited retroactively. *Hassett v. Welch*, 303 U.S. 303 (1938).

To interpret § 641(b)(2) properly, § 641 must be read in conjunction with § 642. Section 642 requires that taxpayers report transfers of Project occurring between January 1, 1984 and June 18, 1984 if the transfer was not shown as taxable on a return. Both § 641 and § 642 were passed in the wake of *Haffner*, while the appeal of the case to the Seventh Circuit was pending; both sections were intended to provide a mechanism for taxing Project Notes in certain estates if *Haffner* were to be reversed. Section 641(b)(1) imposes estate tax on the estates of decedents who died on or after June 19, 1984. But this provision has no application to decedents who died before June 19, 1984, but whose executors had yet to file an estate tax return.[12] It is only to this latter class of estates to which the retroactivity provisions of § 641(b)(2) apply.

Thus, under §§ 641 and 642, estates whose decedents had died before June 19, 1984, but which had not yet filed a return, were given a choice. In light of the possible reversal of the *Haffner* decision, a conservative executor could show the Project Notes as taxable on the return and thereby avoid the possibility of incurring interest and late payment penalties should *Haffner* indeed be reversed. But such a taxpayer who listed the Project Notes as taxable could not, by virtue of § 641(b)(2), sue for a refund if *Haffner* were affirmed. Conversely, a more aggressive executor could decline to show the Project Notes as taxable on the return. However, under § 642, an estate that followed this course was required to report the Project Notes to the IRS "to allow the determination of the tax and interest due if it is ultimately determined that

[12]Executors have nine months after the decedent's death to file a federal estate tax return. 26 U.S.C. 6075(a).

such transfers are subject to estate, gift, or generation-skipping tax." In other words, if *Haffner* were reversed, such estates would be taxed and could be subject to interest or late payment penalties.

Section 641(b)(2) thus has retroactive application *only* to estates whose decedents died before June 19, 1984, but which filed a return after that date and listed the Project Notes as taxable. The "if at any time" language in § 641(b)(2) thus refers only to returns filed at any time after June 19, 1984, regardless of the date of transfer. This limited retroactivity comports with the normally short period of retroactivity found in most tax statutes, and ameliorates the problems of foreseeability: an executor of such an estate could *choose* retroactivity by showing the notes as taxable or avoid it by reporting under § 642.

Under this correct interpretation, § 641(b)(2) would have no applicability to the Project Notes in the *Stein* estate, since Appellees filed the estate tax return years before June 19, 1984. Moreover, the issues of constitutionality are not implicated.

V.

CONCLUSION

For the foregoing reasons, it is Appellees' position that the district court properly rendered judgment in their favor.

Respectfully submitted,

ROBERT H. ROTSTEIN
(Counsel of Record)

KATHERINE T. PRATT
THOMAS P. SMITH
Attorneys for Appellees
Crocker National Bank,
Lew R. Wasserman, and
Ruth S. Cogan, as
Executors of the
Will of Jules C. Stein

of Counsel:
ROSENFELD, MEYER & SUSMAN

PROOF OF SERVICE BY MAIL

I am a citizen of the United States and a resident of the City and County of Los Angeles; I am over the age of eighteen years and not a party to the within action; my business address is: 1706 Maple Avenue, Los Angeles, California.

On April 21, 1987, I served the within MEMORANDUM OF APPELLEES in re: "United States of America vs. Crocker National Bank" in the United States Supreme Court, October Term 1986, No. 86-1521;

on the Parties in said action, by placing Three copies thereof enclosed in a sealed envelope with postage fully prepaid, in the United States post office mail box at Los Angeles, California, addressed as follows:

CHARLES FRIED, *Solicitor General*
ROGER M. OLSEN,
Assistant Attorney General
ALBERT G. LAUBER, JR.,
Deputy Solicitor General
ALAN I. HOROWITZ,
Assistant to the Solicitor General
MICHAEL L. PAUP, *Attorney*
ERNEST J. BROWN, *Attorney*
Department of Justice
Washington, D.C. 20530

ROBERT C. BONNER,
United States Attorney
CHARLES H. MAGNUSON,
Assistant United States Attorney,
Chief, Tax Division
JEFFREY G. VARGA,
Assistant United States Attorney
2315 Federal Building
300 N. Los Angeles Street
Los Angeles, California 90012

All Parties required to be served have been served.

I certify (or declare), under penalty of perjury, that the foregoing is true and correct.

Executed on April 21, 1987, at Los Angeles, California

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MOTION

SUPREME COURT, U.S.
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(3)

No. 86-1521

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1986

UNITED STATES OF AMERICA,
Appellant,

v.

HARRY ROSENBERG and ARTHUR ROSEN, etc.
Appellees.

On Appeal from the United States District Court for the Central District of California

MEMORANDUM BRIEF OF APPELLEES ROSEN and ROSENBERG Co-Trustees of the Morris Folb Trust

MARK G. ANCEL

BAKER, ANCEL, MORRIS & HRUBY
626 Wilshire Boulevard
Seventh Floor
Los Angeles, CA 90017
(213) 624-9201
Attorneys for Appellees

Bowne of Los Angeles, Inc., Law Printers (213) BOWNE CO

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No. 86-1521

In the Supreme Court
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OCTOBER TERM, 1986

UNITED STATES OF AMERICA,
Appellant,

v.

HARRY ROSENBERG and ARTHUR ROSEN, etc.
Appellees.

On Appeal from the United States District Court for the Central District of California

MEMORANDUM BRIEF OF APPELLEES
ROSEN and ROSENBERG
Co-Trustees of the Morris Folb Trust

PRELIMINARY STATEMENT

The following facts should supplement the Jurisdictional Statement of Appellant:

1. At the time of the filing of the federal estate tax return discussed in pages 2 and 3 of the Jurisdictional Statement, Schedule C of the federal estate tax return itself referred to the Project Notes as "tax exempt" (Schedule C, Federal Estate Tax Return, Form 706, pages 1 and 40, Motion for Summary Judgment of the UNITED STATES).

2. There has never been a denial of the claimed refund by the Commissioner. No action whatsoever was undertaken, When six months had elapsed without any action, the claim was deemed denied and the instant action was filed by the fiduciaries.

3. When the Appellant made its Motion for Summary Judgment, a fair reading of the moving papers discloses that it relied primarily upon section 641(b)(2) of the Deficit Reduction Act of 1984, Pub.L. No. 98-369, 98 Stat. 494 (hereinafter "DEFRA"). Appellant's discussion of *Haffner* was virtually a copy of its brief to the Circuit, which briefs were presented by Appellees to the District Court.

4. Following the adverse ruling by the Seventh Circuit Court in *Haffner v. United States,* 585 F.Supp. 354 (N.D. Ill. 1984), aff'd., 757 F.2d 920 (7th Cir. 1985), the United States determined not to petition for certiorari. The attorneys in the tax division of the U.S. Department of Justice who prepared the Jurisdictional Statement herein, on August 15, 1984, filed with the Seventh Circuit the appeal from the judgment of the Northern District Court in *Haffner.* In their opening brief of some 42 pages, substantial portions of which were adopted almost without modification in Appellant's motion for the case at bar, the issues relating to the Housing Act were extensively briefed and presented to the Circuit Court. The Court in the course of the *Haffner* appeal was advised of the enactment of DEFRA.

5. In *Haffner* the Project Notes issued by local housing agencies were set forth on Schedule B of the 706 as stocks and bonds, but the value was not included in the gross taxable estate. Instead, a listing was set forth saying that the notes were not taxable, pursuant to section 11(b) of the Housing Act of 1937. On audit by the Service, the Project Notes were included in the decedents gross estate

at their face amount, plus interest accrued to the date of the decedent's death, and deficiency of $630,080.76 in federal estate taxes was assessed against the taxpayer's estate and was paid by the Executors, together with interest in the amount of $83,785.23 on January 26, 1980. Almost three years later, on November 10, 1982, the Executors filed a claim for refund of the state taxes in the amount of $614,905.69 plus interest, asserting that inclusion of the Project Notes in decedent's gross estate was erroneous. Nowhere in the briefs of the United States before the Seventh Circuit in the *Haffner* case is it asserted that the listing of the notes on the 706, the delay in filing for refund and the payment of the tax without protest following the assessment was tantamount to an admission that the amounts assessed were owing.

6. In the Reply Brief of the Appellant filed in the *Haffner* Appeal on November 6, 1984, mention is made of the DEFRA statute. The legislative history of the Housing Act was again extensively reviewed in the Reply Brief, even unto the number of Senators who responded to a quorum call. In its Reply Brief in the *Haffner* appeal, the government advised the Seventh Circuit Court: "... Section 641 of DEFRA is *made applicable only to estates of decedent's dying, and gifts and transfers made, after June 19, 1984.* But section 642 requires that all transfers made after December 31, 1983, and before June 19, 1984, be reported to the Treasury and imposes a substantial penalty for failure to report ..." (emphasis added). This point was made in response to the questioning of the government's motive in advising the court of the enactment of section 641.

7. Based upon the statements made in footnotes 3 and 6 of the jurisdictional statement, Appellant knew, or should have known, that the Project Notes in decedent's estate would be in the hands of fiduciaries who would be

represented by practitioners who would have to report the Notes and would file a claim for refund and, until final determination, would be obligated to prosecute the action where estate taxes had been paid. The intent of the Service not to seek certiorari was publicized by the Service which stated it would rely upon its Revenue Ruling 81-63. C.C.H Est. & Gift Tax Repts. Letter 101, July 8, 1985.

8. The Appellant determined that it would not seek early resolution of the *Haffner* decision and chose to resolve the matter prospectively by reason of the enactment of DEFRA. The Service knew that the District Court would follow *Haffner*, in order to provide for uniform administration of the tax laws. *First Charter Financial Corp. v. United States* (9th Cir. 1982) 669 F.2d 1342, 1345; *Gulf Island Corp. v. United States* (5th Cir. 1978) 570 F.2d 1277, 1278 (favoring uniform administration of the tax laws); *North American Life & Casualty Co. v. Commissioner* (8th Cir. 1976) 533 F.2d 1046, 1051 (same); and *Federal Life Insurance Co. v. United States* (7th Cir. 1975) 527 F.2d 1096, 1098-99 (same).

9. Appellant was aware of the history of the adoption by numerous states of provisions to implement the United States Housing Act of 1937 soon after its enactment. *See, e.g., The Housing Authority of the County of Los Angeles v. Dockweiler* (1939) 14 Cal.2d 437, 94 P.2d 794, and the cases therein cited in the various jurisdictions, holding that the enactment of the implementing legislation in the various states was for a public purpose and the Project Notes issued by local housing authorities were to be exempt from all forms of taxation. *The Housing Authority v. Dockweiler, supra*, page 455.

DISCUSSION

A. *Haffner* Should Not Be An Issue.

The United States failed to petition for certiorari from the *Haffner* decision, notwithstanding the fact that it knew that numerous fiduciaries would be involved with the question raised by that case and would have to proceed with refund claims. Undoubtedly, the Service was aware of the numbers of claims for refund that were filed in the various districts at this point in time, but chose not to get a speedy resolution at the earliest date. See footnotes 3, 4 and 6 of the Jurisdictional Statement.

Appellant was also well aware of the policy within the Ninth Circuit, to rely upon the decisions of other circuits in tax matters. In fact, the Appellant, in the Motion for Summary Judgment, in discussing the *Haffner* issue, i.e., whether the notes were themselves excludable from the gross taxable estate, adopted *in haec verba* the arguments and authorities and wording of the briefs which it had filed in the Seventh Circuit.

In short, the validity of the *Haffner* decision should not be an issue in this case. The Appellant should have exhausted its remedies in *Haffner* and should not now relitigate the validity of that opinion. While this Court has concluded in the *United States v. Mendoza* (1984) 464 U.S. 154, 78 L.Ed.2d 379, 104 S.Ct. 568, that the government is not estopped on the issue of constitutionality, it is submitted that the present case falls within the purview of *United States v. Stauffer Chemical Co.* (1984) 464 U.S. 165, 78 L.Ed.2d 388, 104 S.Ct. 575, and *Montana v. United States* (1979) 440 U.S. 147, 55 L.Ed.2d 210, 99 S.Ct. 970. For all practical purposes, the Appellees, and every decedent's estate with Project Notes, where death had occurred prior to the enactment of DEFRA, and where the Act must be interpreted in a retroactive fashion, are

virtually in the same position by reason of the necessity of claims for refund to be filed with the Service, as to which the ministerial body would have been on notice, and that uniformity of tax law and efficiency of administration are all involved. There would be no freezing of the law because Congress has already resolved the issue prospectively, and there would be a tremendous saving of Court time, not to mention expense, to the estates which have fiduciaries who cannot let the matter sit. The certainty required by the tax laws would be enhanced, and the issues should therefore be narrowed as to whether or not Congress had the power under section 641(b)(2) to effect retroactively the taxation of the Project Notes following the *Haffner* decision.

B. There Is No Authority Supporting Appellant's Interpretation of DEFRA.

Additionally, the Service's position relating to substantial authority, its functions under Circular 230, the obligations of practitioners under the various ethics opinions of the American Bar Association, would be aided by following the District Court's opinion. Furthermore, it is the conscious policy of the Service to apply uniform treatment to taxpayers under the virtually identical facts. This is the reason why Revenue Ruling 81-63, 1981-1 Cum. Bull. 455, required the appellees in this situation to report and pay the tax on the Project Notes. The Jurisdictional Statement, in relying upon the statement of the Staff of the Joint Committee, relies upon that which is not substantial authority for legal positions. Thus, in the case of the income tax, Treasury Regulations 1.6661-3(b)(2) state: "... General explanations prepared by the Staff of the Joint Committee on taxation are not authority." It is true, however, that the enacted legislation prospectively removes all possibility of decedents making transfers or inter vivos transfers subsequent to the applicable date of

the legislation. The vice with which the District Court as concerned stems from the situation in which a taxpayer or his estate had filed a tax return, setting forth the Project Notes as being subject to transfer tax. If the logic of Appellant is adopted, one need not report the notes at all prior to December 31, 1983. In fact, under the provisions of Revenue Ruling 81-63, and what would be good practice, taxpayers would have no choice, where represented by competent practitioners, but to file the estate tax return, report the market value of the notes, and thereafter seek a refund in the event that the *Haffner* decision were to be upheld. This would be particularly true from the viewpoint of a practitioner who would be deemed to be aware of Revenue Ruling 81-63, 1981-1 Cum.Bull. 455, Circular 230, 31 CFR 10 and proposed revisions, dated July 18, 1986, BNA Daily Tax Report No. 157, August 14, 1986, and Ethics Opinion 314 as modified by ABA Ethics Formal Opinion 85-352 (1985). Not reporting the Project Notes after 1981 would result in possible imposition of a penalty and a basis to prevent the return preparer from practicing before the Treasury.

C. Retroactive Application Denies Due Process and Equal Protection of the Laws.

Not only do the provisions of DEFRA not address the gift and estate tax treatment of Project Notes transferred or held by persons dying before June 19, 1984, in circumstances where no tax return was filed setting forth the Project Notes as being subject to tax, but also, they affirmatively exempt such Project Notes from being subject to taxation. In other words, Fiduciaries who follow a revenue ruling and proper statutory procedure pay tax, and those who have ignored the provisions of Circular 230, and the provisions of Regulation 81-63 (which in itself comprises substantial authority) requiring the set-

ting forth of said obligations on the tax returns are not required to pay estate tax.

The argument made by Appellant is simply too broad. It is predicated upon the assumption that taxpayers must file notice of protest before paying tax, or lose any claim which they might otherwise have, unless they totally fail to report on the tax return all the existence of Project Notes. The protest statutes were repealed in 1924, and the utilization of the filling out of a return, whether an estate tax return or an income tax return, and the payment of tax in order to cease the running of interest and penalties are an everyday occurrence with respect to those persons who are engaged in activities involving the payment of taxes.

Additionally, it is argued that the holding would disable Congress from enacting curative legislation to prevent taxpayers from obtaining windfall benefits from erroneous court decisions. The decision may be erroneous in the mind of counsel, but it certainly represents the law, which, under the income tax regulations and proposed amendments to Circular 230, comprises substantial authority in all of the circuits of the United States and in the district court. The Appellant should have attempted to take this matter up to get a definitive ruling from the court, instead of hoping for some kind of a split in the circuits when dealing with fiduciaries.

The holding of the District Court applies only to the facts of the case. In the argument made that the Congress would be disabled from enacting curative legislation, one discerns a certain bureaucratic tintinnabulation. The point is, there can be no rational classification, based upon the history of the protest statutes and based upon common sense, which says that one who files a tax return and reports honestly and honorably must lose, while people with motives of defrauding the government from

its just share of tax, who do not report the assets, win; nor does it make any sense predicated upon the facts of *Haffner*, where, although the items were listed on the return as not being taxable on the *ipse dixit* of the taxpayer, the government nevertheless made an assessment and the taxpayer paid the money and then filed a claim for refund.

Appellees have a protected property interest in a refund of the estate taxes paid on the Project Notes' value because they have a legitimate claim for statutory entitlement under the interpretation of the Seventh Circuit and the District Court in *Haffner* of the Housing Act of 1937. This legitimate claim of statutory entitlement to refund was available and existed prior to the enactment of DEFRA section 641(b)(2). Application of this provision to such a claim for refund would retroactively deprive Appellees of their pre-existing protected property interest in the claimed refund. This deprivation is constitutional only if the government had afforded Appellants constitutionally adequate process to safeguard the protected property interest. U.S. Constitution, Amendment 5. Such action can be taken only if the test of *Matthews v. Eldridge* (1976) 424 U.S. 319, 335, 47 L.Ed.2d 18, 96 S.Ct. 893, has been met. In this case, such tests are not met because the retrospective application of section 641(b)(2) retroactively deprives the Appellees of their protected property interest in the claimed refund. The dearth of legislative history on this particular provision suggests that it escaped meaningful consideration in Congress and probably went unnoticed when the 1984 tax act was being enacted. In any event, there was not a meaningful hearing afforded to the Appellees, or a chance to defend their claim for refund before the Appellant finally deprived them of their protected interest in the claimed refund. Moreover, the summary retroactive deprivation carved out a class of individuals who at any time

had filed an estate tax return reporting the Project Notes as subject to federal estate taxes. DEFRA § 641(b)(2).

In a consistent line of tax cases this Court has held that a statute purporting to tax may be so arbitrary and capricious as to amount to confiscation and offend the Fifth Amendment. *Nicholas v. Coolidge* (1927) 274 U.S. 531, 542. In *Blodget v. Holden* (1927), modified 276 U.S. 594 (1929), 275 U.S. 142, it was held that the Revenue Act of 1924 insofar as it sought to impose a tax on gifts made prior to the effective date of the Act was arbitrary and invalid under the due process clause. In *Untermeyer v. Anderson* (1928) 276 U.S. 444, the Court held with respect to the Revenue Act of 1924 that the application of tax, even as applied to gifts made while the Act was pending before the Congress, was so unfair and arbitrary that it violated the due process clause. Appellant then seeks to distinguish *Untermeyer*, citing, among other cases, *United States v. Hemme*, No. 84-1944 (June 3, 1986), which clearly involved not a new tax, but a transitional rule adopted to preclude taxpayers from enjoying a double benefit of the specific $30,000 exemption and the new unified credit available under the 1976 Act, which had replaced estate and gift tax exemptions with a unified credit against both estate and gift taxes. In the present case, neither the decedent nor the Appellees could have, nor should have, anticipated the enactment of DEFRA. Project notes were not taxable at the date of the Testator's death, nor at the time the estate tax return was filed. The federal estate tax applies at the time of death to the value of assets owned at death. It is triggered by the decedent's death. Death is not reversible. The decedent had no opportunity after his death to rearrange his financial affairs. He was precluded from any further estate tax planning. Because of these circumstances, the retroactive application of the estate tax is especially onerous, repugnant and arbitrary and capricious.

The retroactive provisions of DEFRA also violate the due process clause of the Fifth Amendment which limits the federal government in the same way that the equal protection clause of the Fourteenth Amendment limits the states. *Regan v. Taxation With Representation of Washington* (1983) 461 U.S. 540, 542, n.2, 76 L.Ed.2d 129, 103 S.Ct. 1997. In order to meet the provisions of the equal protection component of the Fifth Amendment, a tax classification must rationally relate to a legitimate government purpose. *Hooper v. Bernalilollo County Assessor* (1985) 472 U.S. ____, 86 L.Ed.2d 487, 493, 105 S.Ct. 2862.

Under the authority of *Haffner*, a taxpayer who paid estate taxes on Project Notes had a legitimate claim for statutory entitlement to an estate tax refund. The procedure to be followed with such a refund or any other tax refund would be to file a claim with the Internal Revenue Service, wait at least six months, or receive the Service's notice of disallowance, and then commence suit in the United States District Court. 26 U.S.C. § 6532(a)(1) and § 7422(a). Moreover, such a suit could be maintained in the District Court whether or not such tax has been paid under protest or duress. § 7422(b) The only additional requirement, of course, as heretofore discussed, is the payment of the contested tax liability prior to maintenance of the suit for refund in the District Court. Therefore, in filing the estate tax return, paying the disputed estate tax and filing a claim for refund with the Service, the Appellees complied with all legal requirements. However, if the section of DEFRA is applied, any right to a refund is extinguished because the filing of the return showing Project Notes as subject to federal estate taxes even though neither protest nor duress in the payment of such liability are necessary for a refund. In other words, the classification, if applied to Appellees claim, would retroactively deny them of a refund for the very reason

that they have done what the applicable law requires of every taxpayer in order to obtain a refund.

D. The Decision of the District Court has a Minimal Impact Upon the Fisc.

The tax consequences of the holding are minimal. Some of the Project Notes set forth in footnotes 3 and 6 to the Jurisdictional Statement probably involve claims that have been filed by practitioners within what, arguably, would be the effective date of DEFRA, although Appellant gives us no breakdown. A large number probably are not within such periods and therefore no tax will be due if according to the Appellant they were not reported as taxable. The Appellant does not set forth the breakdown as the dates or the types of claims being made on the Project Notes. There are no facts set forth relating to decedents, as was the case here, who would have not been in a position to do any planning whatsoever. Additionally, Project Notes could well have been a portion of estates with notes or very small sums by reason of the credit exemption amounting to as much as $325,000 in 1984, and the Appellant does not choose to give us the amounts of tax actually involved. Additionally, the Service, as is hereinafter set forth, prior to litigation, has settled claims in situations similar to those herein at less than 50% of the amount assertedly due, although the amounts of Project Notes involved are not set forth in the footnote. Finally, none of the information set forth is in the record.

Counsel for Appellees is advised that the United States, in the New York District has settled claims similar to those of Appellees, prior to the filing of litigation, on the basis of forty percent (40%) of the amount of the tax claimed. Counsel for Appellees has attempted, consistently, to settle these matters with the UNITED

STATES, and has been told that the Appellant will not settle.

E. Retroactivity Also Violates the Separation of Powers.

It should also be observed that at page 4 of the Jurisdictional Statement, in the second paragraph, the statement is made "... Congress enacted legislation within three months to overturn the *Haffner* decision. ..." While the District Court refused to rule on the argument made by appellee that section 641(b)(2) retroactivity revoked the effect of the *Haffner* decision (footnote 4, pages 17a and 18a of Jurisdictional Statement), such retroactive action would, in fact, violate the Constitutional doctrine of the Separation of Powers. It would disrupt the judicial system by granting to the Legislature a selective power to override individual adjudications, instead of the usual prospective corrective device of a statutory amendment, which in fact was the situation relating to section 641(b)(1) of DEFRA. It would interfere with the court's essential function of determining the proper application of the law in force at the date of the decedent's death. Such retrospective application would otherwise undermine the court's decision, to legislative retroactive reversal, notwithstanding the soundly reasoned decision and the failure of the Appellant to petition this Court for certiorari.

The judicial system would also be subjected to an overriding power on a selective basis by the Legislature, and such a situation would tolerate a congressional disapproval device that could convert nearly all judicial interpretations of statutory criteria, as interpreted by the courts, into mere advisory opinions which the Congress can ignore and can overrule at will through retroactive legislative action. *See, Chadha v. Immigration and Natu-*

ralization Service (9th Cir. 1980) 634 F.2d 408, 420, aff'd. on other grounds (1983) 462 U.S. 919, 77 L.Ed.2d 317, 103 S.Ct. 2764.

Additionally, because of the Jurisdictional Statement's statement (on pages 2 and 3) to the effect that payment of the sum reflected a belief that the Project Notes were subject to tax and that no claim for refund could legitimately be filed, the Appellant is urging an implied repeal of statutes which do away with the requirement of protest or the adoption of a requirement of payment under protest. If it had so intended, the Congress could have amended section 7422(b) of the Internal Revenue Code, 26 U.S.C. 7422(b), which provides as follows:

> "(b) PROTEST OR DURESS — Such suit or proceeding may be maintained whether or not such tax, penalty or sum has been paid under protest or duress."

It should also be noted that no protest is required in the statutes relating to the filing of a claim for refund set forth in 26 U.S.C. §§ 6511 and 6532, and such position of the Appellant not only impliedly amends those statutes, but engrafts an additional requirement to the provisions that full payment of the contested liability is a jurisdictional prerequisite to a suit for refund in the United States district court. *Flora v. United States* (1958) 357 U.S. 63, 2 L.Ed.2d 1165, 78 S.Ct. 1079, aff'd. (1960) 362 U.S. 145, 4 L.Ed.2d 623, 80 S.Ct. 630, rhrg. denied (1960) 362 U.S. 972, 4 L.Ed.2d 902, 80 S.Ct. 953.

In short, in filing the estate return, paying the disputed estate tax, and filing a claim for refund with the Internal Revenue Service, the Appellees have complied with all of the statutory and legal requirements for a refund suit against Appellant in the United States district court. The Appellees have done what is required of

every taxpayer in order to obtain a refund, and an engraftment of retroactivity and nonreporting on a federal estate tax return as a prerequisite to a valid claim against Appellant in this factual context would nullify the provisions of 26 U.S.C. § 7422(b) by retroactively requiring protest.

F. Both Law and Common Sense Support the Opinion of the District Court.

In its footnote 4, Appellant seems to state that *Netsky v. United States* 86-1616 (3d Cir.) as decided by the District Court is inconsistent with the case at bar. It is respectfully submitted that that case is entirely consistent, stating that the application of section 641(a) of DEFRA would be unconstitutional if construed to apply retroactively to estates which had filed claims for refund before the effective date of DEFRA.

The Appellant is reduced on page 10 of its Jurisdictional Statement to cite a dissenting opinion which could not, under any of the tax statutes, serve as substantial authority for any position. It then continues on with the unique statement that the long-dead Senator Walsh expounded his own "misunderstanding" of the ordinary connotation of the term "tax exempt". The Seventh Circuit Court and the District Court in *Haffner* wrote well reasoned opinions which utilized lengthy and complete briefs exhausting the legislative history of the Housing Act. The emotional and pejorative description of the statements do not contribute any substance to the fundamental issue of whether or not, where the statute is deemed to be retroactive, a distinction predicated purely on a reporting of the Project Notes on the federal estate tax return is in essence a failure to protest the payment of the tax and therefore an admission of it being owing where no federal statute may be so construed.

The insubstantiality of Appellant's position is further illustrated by the argument made on page 11 that common sense requires a ruling in favor of the government in respect of the *Haffner* decision because the estate tax exemption had gone unclaimed by taxpayers, unacknowledged by the IRS and unrecognized by the courts for some 45 years. Suffice it to say that if recognition by the Internal Revenue Service is the criterion, then the settlements made by the Internal Revenue Service in the District of New York should serve as an admission by Appellant that the position of the Appellees has substantial merit. Beyond that, it is obvious that no progress would ever be made in the law if the assertions of appellant's counsel are taken at face value. This Court had no problem with such arguments when made in the case of *Michelen v. Wages* (1976) 423 U.S. 276, 46 L.Ed.2d 495, 96 S.Ct. 525, reh.den. 424 U.S. 935 and 7 L.Ed.2d 344, 96 S.Ct. 1151 when it struck down the original package doctrine which had been in effect for well over 100 years and reversed the precedential case of *Low v. Austin* (1871) 80 U.S. (13 Wall.) 29, 20 L.Ed. 517.

The argument at page 14 of the Jurisdictional Statement simply does not wash. If the Courts interpreted the Housing Act of 1937 to exempt from the application of the estate tax Project Notes issued by reason of the Act, then the provisions of DEFRA, which go back to the period when such notes would not have been subject to estate taxation, results in the imposition of a new tax by any interpretation of language.

The argument made on page 15 under paragraph b that the distinction drawn by Congress between persons who had reported Project Notes on federal estate tax returns as being subject to estate or gift tax and those who had not done so as being designed to eliminate any possible perception of unfairness in the statutes retroactive appli-

cation is simply unintelligible and at best pure sophistry. Tax laws must be clear to all, particularly in the estate tax area, without getting into the subjective intent of a decedent who has purchased Project Notes several years before death, and whose executors, following all of the ethical requirements of the American Bar Association, all legal requirements, and all of the requirements of Treasury Department Circular 230, set forth the notes on a tax return, pay the tax, and claim a refund. The Appellant seeks unilaterally to rescind the statute doing away with protest. To follow Appellants' logic is to reinstate the common law requirement of payment under protest and under the Federal Statutes repealed in 1924 by the Revenue Act of that year. Chap. 234, 43 Stat. at L. 253, 343, § 1014 amending Rev. Stat. § 3226, 926 U.S. L. Sec. 156. Section 3226 was the predecessor to section 7122(b) of the code and the refund claim sections under which the claim herein was made. In interpreting the Statute and holding that a taxpayer may initiate a suit for refund even though the tax was not paid under protest, this Court emphasized that the policy doing away with protest should be liberally construed, since the amendment was

designed to right an ancient wrong, *George Moore Ice Cream Company v. J.T. Rose, Collector of Internal Revenue for the District of Georgia* (1933) 289 U.S 373, 376-379, 77 L.Ed. 1265. Appellant now seeks to repeal by implication what has been settled statutory law for over sixty years.

Dated: April 21, 1987.

Respectfully submitted,

BAKER, ANCEL, MORRIS & HRUBY

By MARK G. ANCEL

Attorneys for Appellees Harry Rosenberg and Arthur Rosen, Co-Trustees of The Morris Folb Trust

PROOF OF SERVICE BY MAIL

I am a citizen of the United States and a resident of the City and County of Los Angeles; I am over the age of eighteen years and not a party to the within action; my business address is: 1706 Maple Avenue, Los Angeles, California.

On April 21, 1987, I served the within MEMORANDUM BRIEF OF APPELLEES in re: "United States of America vs. Harry Rosenberg and Arthur Rosen" in the United States Supreme Court, October Term 1986, No. 86-1521;

on the Parties in said action, by placing Three copies thereof enclosed in a sealed envelope with postage fully prepaid, in the United States post office mail box at Los Angeles, California, addressed as follows:

Charles Fried, Solicitor General
Roger M. Olsen, Assistant Attorney General
Albert G. Lauber, Jr., Deputy Solicitor General
Alan I. Horowitz, Assistant to the Solicitor General
Michael L. Paup
Ernest J. Brown, Attorneys

U.S. Department of Justice
10th and Constitution Avenue, N.W.
Washington, D.C. 20530

All Parties required to be served have been served.

I certify (or declare), under penalty of perjury, that the foregoing is true and correct.

Executed on April 21, 1987, at Los Angeles, California

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(N)

APPELLANT'S BRIEF

Supreme Court, U.S.
FILED
AUG 13 1987
JOSEPH F. SPANIOL, JR.

No. 86-1521

In the Supreme Court of the United States

OCTOBER TERM, 1987

UNITED STATES OF AMERICA, APPELLANT

v.

WELLS FARGO BANK, ET AL.

UNITED STATES OF AMERICA, APPELLANT

v.

HARRY ROSENBERG AND ARTHUR ROSEN, ETC.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE CENTRAL DISTRICT OF CALIFORNIA

BRIEF FOR THE UNITED STATES

CHARLES FRIED
Solicitor General

MICHAEL C. DURNEY
Acting Assistant Attorney General

ALBERT G. LAUBER, JR.
Deputy Solicitor General

ALAN I. HOROWITZ
Assistant to the Solicitor General

MICHAEL L. PAUP
ERNEST J. BROWN
DAVID I. PINCUS
Attorneys

Department of Justice
Washington, D.C. 20530
(202) 633-2217

QUESTIONS PRESENTED

1. Whether obligations of public housing agencies owned by the decedents were excludable from their gross estates for purposes of the federal estate tax by virtue of the United States Housing Act of 1937, as amended.

2. If the first question is answered in the affirmative, whether Section 641(b)(2) of the Deficit Reduction Act of 1984 (98 Stat. 939) violates the Fifth Amendment in making such obligations includible in the gross estates of decedents who died before that provision's effective date, but whose representatives reported those obligations on their estate tax returns as subject to estate tax.

PARTIES TO THE PROCEEDING

Crocker National Bank, Lew R. Wasserman and Ruth S. Cogan were all plaintiffs in District Court No. CV 85-7614 as Executors of the Will of Jules C. Stein. Wells Fargo Bank is the successor in interest to Crocker National Bank. Harry Rosenberg and Arthur Rosen were plaintiffs in District Court No. CV 85-3465 as co-trustees of the Morris and Tillie Folb Trust, FBO Tillie Folb.

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In the Supreme Court of the United States

OCTOBER TERM, 1987

No. 86-1521

UNITED STATES OF AMERICA, APPELLANT

v.

WELLS FARGO BANK, ET AL.

UNITED STATES OF AMERICA, APPELLANT

v.

HARRY ROSENBERG AND ARTHUR ROSEN, ETC.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE CENTRAL DISTRICT OF CALIFORNIA

BRIEF FOR THE UNITED STATES

OPINION BELOW

The opinion of the district court (J.S. App. 1a-18a) is unofficially reported at 86-2 U.S. Tax Cas. (CCH) ¶ 13,703.

JURISDICTION

The judgments of the district court (J.S. App. 19a-20a) were entered on October 20, 1986. The notices of appeal to this Court were filed on November 19,

1986 (J.S. App. 21a-24a). On January 12, 1987, Justice O'Connor extended the time for docketing the appeals to and including March 19, 1987. The jurisdictional statement was filed on that date, and probable jurisdiction was noted on May 18, 1987. The jurisdiction of this Court rests on 28 U.S.C. 1252.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The relevant constitutional and statutory provisions are set forth in a statutory appendix (App., *infra*, 1a-2a).

STATEMENT

1. These appeals are taken from judgments in two cases that were consolidated in the district court. They present identical legal issues relating to the estate tax treatment of certain short-term obligations of state and local public housing agencies ("Project Notes"). The interest paid on Project Notes is exempted from federal income tax by the Housing Act of 1937, as amended. The question here is whether the testamentary transfer of Project Notes is exempt from federal estate tax.

Appellees in the *Wells Fargo* case are the executors under the will of Jules C. Stein, who died on April 29, 1981.[1] At the time of his death, Stein owned Project Notes in the aggregate face amount of $9,550,000, which matured on various dates in 1981 subsequent to his death. On January 29, 1982, appellees filed a federal estate tax return for Stein's estate. On that return, appellees included these Project Notes, plus accrued interest, in the gross estate.

[1] Appellee Wells Fargo Bank is the successor in interest to Crocker National Bank, which was one of the original executors.

The return showed as due, and appellees paid, estate tax in the amount of $10,874,767, a sum that reflected appellees' understanding that transfers of the Project Notes were subject to tax. Two and a half years later, on June 29, 1984, appellees filed a claim for refund of $1,320,097 in estate tax, plus interest. This refund claim was premised on the assertion that the Project Notes in fact were exempt from estate tax and should not have been included in the gross estate. The Commissioner denied the refund claim. J.S. App. 3a.

Appellees in the *Rosenberg* case were co-executors of the estate of Morris Folb, who died on July 1, 1982, and are co-trustees of a trust to which Folb's net estate was distributed. At the time of his death, Folb owned Project Notes in the aggregate face amount of $250,000, which matured on various dates in 1982 subsequent to his death. On March 30, 1983, appellees filed a federal estate tax return for Folb's estate. On that return, appellees included these Project Notes, plus accrued interest, in the gross estate. The return showed as due, and appellees paid, estate tax in the amount of $221,519, a sum that reflected appellees' understanding that transfers of the Project Notes were subject to tax. More than a year later, on August 15, 1984, appellees filed a claim for refund of $84,596 in estate tax, plus interest. This refund claim was premised on the assertion that the Project Notes were exempt from estate tax and should not have been included in the gross estate. The Commissioner denied the refund claim. J.S. App. 2a-3a.

2. The refund claims in these cases were triggered by the district court decision in *Haffner* v. *United States*, 585 F. Supp. 354 (N.D. Ill. 1984), aff'd, 757 F.2d 920 (7th Cir. 1985), which held that com-

parable Project Notes were not includible in a decedent's gross estate for federal estate tax purposes. The district court in *Haffner* bottomed its decision on what is now 42 U.S.C. 1437i(b), enacted in its original form as Section 5(e) of the United States Housing Act of 1937 (Housing Act of 1937 or 1937 Act), ch. 896, 50 Stat. 890. That section provides that Project Notes "shall be exempt from all taxation now or hereafter imposed by the United States." The *Haffner* court acknowledged the "general rule * * *, that an exemption from all taxation * * * generally does not affect the imposition of estate and other excise taxes" (585 F. Supp. at 356-357). It viewed Section 5(e) as different, however, because of what it found to be a "strong indication" (*id.* at 357) that Congress in 1937 intended to exempt Project Notes from federal estate taxation.

The *Haffner* court relied primarily on the difference in language between Section 5(e) of the 1937 Act and Section 20(b) of that law. The latter section (50 Stat. 898) provided that obligations of the United States Housing Authority "shall be exempt * * * from all taxation (*except surtaxes, estate, inheritance, and gift taxes*) now or hereafter imposed by the United States or by any State * * * or local taxing authority" (emphasis added). The court reasoned that the absence from Section 5(e) of a similar parenthetical phrase indicated a congressional intent to exempt Project Notes from estate tax (585 F. Supp. at 357-360). The court also relied on a discussion of the 1937 legislation on the Senate floor by Senator Walsh, who stated that the obligations of public housing agencies would be tax-exempt, "which means they are free from income tax, surtax, estate, gift, and inheritance taxes" (81 Cong. Rec. 8085 (quoted in 585 F. Supp. at 359)). And the court

noted that an alternate version of Section 5(e) submitted to the Senate Committee had expressly subjected Project Notes to the estate tax (585 F. Supp. at 358). Hence, the *Haffner* court concluded that Project Notes had been exempt from estate and gift taxation continuously since 1937, inasmuch as Congress had never acted to change that supposed tax-exempt status.

Congressional reaction to the unprecedented holding of the district court in *Haffner* was swift. "[E]xtremely concerned" by the decision (Staff of the Joint Comm. on Taxation, 98th Cong., 2d Sess., *General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984*, at 971 (Joint Comm. Print 1984)), Congress enacted legislation within three months to overturn the *Haffner* decision. Section 641(a) of the Deficit Reduction Act of 1984 (DEFRA), Pub. L. No. 98-369, 98 Stat. 939, entitled "Clarification of Treatment" provides:

> *General Rule.*—Nothing in any provision of law exempting any property (or interest therein) from taxation shall exempt the transfer of such property (or interest therein) from Federal estate, gift, and generation-skipping transfer taxes.

Section 641(b)(1) makes this provision applicable to the estates of decedents dying, and to gifts and transfers made, on or after June 19, 1984, which appears to be the date on which the legislation was approved by the Conference Committee.[2] Section 641(b)(2)

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[2] The Conference Committee Report (H.R. Conf. Rep. 98-861, 98th Cong., 2d Sess.) was issued on June 23, 1984. The statute was passed by both Houses of Congress on June 27, 1984, and was signed into law on July 18, 1984.

also makes the provision applicable to estates of decedents dying, and to gifts and transfers made, prior to June 19, 1984, "if at any time there was filed an estate or gift tax return showing such transfer as subject to Federal estate or gift tax." Under Section 642, taxpayers were required to report all transfers of Project Notes occurring after December 31, 1983, and before June 19, 1984 (98 Stat. 939-940).

Thus, the effect of the 1984 amendments was to overturn the result of *Haffner* (1) prospectively and (2) for any case in which a taxpayer or his estate had filed a tax return treating the transfer of Project Notes as subject to estate or gift tax. The DEFRA provisions do not address the gift and estate tax treatment of Project Notes transferred, or held by persons dying, before June 19, 1984, in circumstances where no tax return was filed showing the Project Notes as being subject to tax. Section 641(b)(3) provides, however, that "[n]o inference shall arise from paragraphs (1) and (2) that any [such] transfer * * * is exempt from federal estate and gift taxes" (98 Stat. 939).

3. Against this statutory background, appellees brought these refund suits in the United States District Court for the Central District of California. Relying on *Haffner*,[3] appellees urged that the testamentary transfer of Project Notes has always been immune from estate tax and hence that the Notes should not have been included in their decedents' gross estates. With respect to DEFRA, appellees argued that it should not be construed to apply retroactively to the estates in this case and, if it did so apply, that such application was unconstitutional because violative of the Fifth Amendment. The government argued that *Haffner* was wrongly decided and that the testamentary transfer of Project Notes has always been subject to estate taxation. In the alternative, if *Haffner* were held to have been correctly decided, the government argued that DEFRA required appellees to include the Project Notes in the decedents' gross estates because appellees had shown those securities as being taxable on their estate tax returns.

The district court granted appellees' motions for summary judgment. Adopting the reasoning and analysis of the district court opinion in *Haffner*, the district court here held that the Project Notes were exempt from federal estate taxation under the Housing Act of 1937 (J.S. App. 18a). The court further held that Section 641(a) of DEFRA was intended to make the estate tax applicable to Project Notes owned by the estates involved here (J.S. App. 5a-8a). Finally, the district court concluded that such a retroactive application of the 1984 statute was unconstitutional (*id.* at 9a-17a).

The court identified two constitutional infirmities in the DEFRA provision. First, the court concluded that the retroactive application of Section 641(a)

[3] Subsequent to the enactment of DEFRA, *Haffner* was affirmed by a divided panel of the Seventh Circuit, with the majority adopting the district court's opinion with minor corrections (757 F.2d 920 (1985)). Judge Posner dissented (*id.* at 921-923). He stated that the district court's opinion relied entirely on "ambiguous tidbits" of legislative history (*id.* at 922) that yielded an "unrealistic analysis of the legislative process" (*id.* at 923). Judge Posner found no support for the conclusion that "Congress meant to grant extraordinary tax favors to the holders of notes of public housing agencies" (*id.* at 922).

violates the Due Process Clause of the Fifth Amendment (J.S. App. 9a-14a). The court recognized that "[t]here is nothing unusual about retroactive tax laws" (*id.* at 9a). It found, however, that "the retroactive removal of the exemption from estate tax equals the imposition of a wholly new tax." It therefore concluded that this Court's decision in *Untermyer* v. *Anderson*, 276 U.S. 440 (1928), which invalidated the retroactive application of the first gift tax, "compels the court to find that retroactive application of Section 641 is arbitrary and invalid under the due process clause of the Fifth Amendment" (J.S. App. 13a).

Second, the court ruled that the application of DEFRA in this case violates the equal protection component of the Fifth Amendment (J.S. App. 14a-17a). The court noted that the statute draws a distinction between two otherwise identical estates that differ only in whether they had listed Project Notes as assets includible in their taxable estates. The court said that there was "absolutely no rational basis" for this distinction (*id.* at 16a). The court did not deny that the evident purpose of the distinction drawn in the statute was to prevent persons from "join[ing] the bandwagon in the wake of *Haffner* in anticipation of a windfall." But the court found such a legislative purpose to be inadequate to justify the statutory distinction because "[t]o deny persons those windfalls based on speculation about the legal position that they have taken is impermissible" (*ibid.*).

SUMMARY OF ARGUMENT

I.

The Internal Revenue Code provides that all property held by the decedent on the date of his death is includible in the gross estate and hence subject to the federal estate tax. Therefore, the testamentary transfer of Project Notes, like the testamentary transfer of any other property, is subject to the estate tax unless those securities are specifically exempted by some other statute. And this Court has stated on numerous occasions that such an exemption must be express, not implied. See, *e.g.*, *United States Trust Co.* v. *Helvering*, 307 U.S. 57, 60 (1939).

This rule against implying tax exemptions is particularly weighty in the case of an estate tax exemption. Whereas the income tax provisions of the Code have long exempted certain types of income from gross income, an exemption for a particular type of asset from the gross estate is almost unprecedented in our history. That is because such an exemption would provide a means by which an individual might defeat the tax by converting his assets into another form shortly before death. Thus, it is well established that a "general" tax exemption, providing that property "shall be exempt from all taxation," does not operate to exempt the transfer of that property from estate tax, gift tax, or other excise taxes. See, *e.g.*, *Murdock* v. *Ward*, 178 U.S. 139 (1900). Accordingly, it is beyond doubt—and the court below did not dispute—that Project Notes are not exempted from estate taxation on the face of Section 5(e) of the Housing Act of 1937, which uses the phrase "exempt from all taxation" and makes no reference to transfer taxes.

Appellees' basic contention is that Congress's intent to create an estate tax exemption for Project Notes can be deduced from the legislative history of the Housing Act of 1937. This contention is flawed in two respects. First, as noted above, such a tax exemption must be express, and cannot be implied from ambiguous scraps of legislative history. Second, the legislative history relied upon by appellees in no way supports the proposition that Congress intended in 1937 to create an estate tax exemption for Project Notes. Appellees rely on a debatable inference from an unrelated statutory provision, on an isolated statement by a single Senator during floor debate, and on the fact that a committee of Congress did not report out a different version of a bill. In our view, the reasons underlying these items of legislative history do not suggest that Congress intended, or even considered, granting an unprecedented estate tax exemption for Project Notes. At a minimum, it is apparent that all three pieces of legislative evidence are open to varying interpretations; neither separately nor in conjunction can they demonstrate the unambiguous intent to create a tax exemption that is required by this Court's decisions.

Finally, common sense counsels against acceptance of appellees' contention that Project Notes have been exempt from estate taxation continuously since 1937. No such exemption was ever acknowledged by the IRS, recognized by practitioners, or claimed by taxpayers until a few years ago. Generally speaking, tax exemptions of such magnitude do not lie dormant for a period in excess of 40 years.

II.

A. Section 641 of DEFRA does not violate due process in preventing appellees from obtaining a refund of estate taxes on the ground that Project Notes should not have been included in the taxable estate. Tax legislation regularly contains some element of retroactivity, and retroactive application of a tax is unconstitutional only if it is found to be "harsh and oppressive." See, *e.g.*, *United States* v. *Hemme*, No. 84-1944 (June 3, 1986). That is plainly not the case here. The statute is designed solely to prevent taxpayers who have already paid their estate taxes from obtaining a windfall refund as a result of an intervening judicial decision that discerned a previously-unrecognized tax exemption—one that Congress thought should not be available. The statute upsets no settled expectations since it applies only to taxpayers who viewed Project Notes as taxable when their tax returns were filed. There is nothing "harsh or oppressive" about holding a taxpayer to his own treatment of items on a tax return that he himself prepared.

B. Section 641 of DEFRA does not violate the equal protection component of the Fifth Amendment in limiting its retroactive application to those taxpayers who treated Project Notes as taxable on their estate tax returns. The classification drawn by Congress plainly is a rational one. It eliminates any possible perception of unfairness by preventing DEFRA from operating retroactively against any taxpayer who might reasonably be thought to have acted in reliance on the assumption that Project Notes were exempt from transfer taxes. In essence, all the statute does is to preserve the *status quo ante* by allowing those taxpayers who had determined to challenge the taxability of Project Notes to continue to pursue the issue in litigation, while preventing

taxpayers who had accepted the taxability of Project Notes on their estate tax returns from changing their position in a refund suit.

ARGUMENT

Appellees paid their estate taxes on the assumption, unchallenged for more than 40 years, that the testamentary transfer of Project Notes is subject to the federal estate tax. Appellees have now sued for a refund of estate taxes, adopting the view of an intervening lower court decision, *Haffner* v. *United States*, 585 F. Supp. 354 (N.D. Ill. 1984), aff'd, 757 F.2d 920 (7th Cir. 1985), that Project Notes are exempt from estate tax. Their claim must fail for two independent reasons.

First, the contention that Project Notes were *ever* exempt from estate tax, which was accepted by the *Haffner* courts, is incorrect. Estate-tax exemptions covering a particular species of property—especially property that is easily transferable, like the securities involved here—are almost unprecedented. That is because such an exemption would allow individuals to defeat the estate tax completely, simply by converting their property into holdings of the exempt type of property before death. This Court therefore has held that a tax exemption of the sort appellees posit can be established only by unambiguous statutory language. The language of the 1937 Housing Act, in and of itself, concededly does not establish such an exemption. It provides only that Project Notes themselves, and the interest paid thereon, shall be exempt from taxation; it does not say that the *transfer* of such securities shall be immune from tax.

Nothing in the legislative history of the 1937 Act, moreover, provides a basis for inferring a congressional intent to create such an unprecedented loophole in the estate-tax scheme.

Second, even if one assumes arguendo that Project Notes at one time were exempt from estate taxation, that exemption was removed by Section 641 of DEFRA, 98 Stat. 939. That provision was enacted with the specific intent of overruling the *Haffner* decision. The DEFRA Amendment applies to appellees, because they filed estate tax returns showing their decedents' transfers of Project Notes as being subject to estate tax. And appellees' challenges to the constitutionality of the 1984 enactment are without merit.

Because the district court held Section 641 of DEFRA unconstitutional, this Court's jurisdiction over this direct appeal rests upon 28 U.S.C. 1252. It is well established, however, that such an appeal brings the entire case before the Court. See *United States* v. *Locke*, 471 U.S. 84, 92 (1985) (citing cases). Thus, the underlying statutory question decided by the district court—whether Project Notes in fact were exempted from federal estate taxation by the Housing Act of 1937—is properly presented here. If this Court holds that the district court, in following the *Haffner* courts, erred in resolving that threshold question, then appellees' refund claims must fail irrespective of DEFRA. It is this Court's usual practice to confront in the first instance statutory issues whose resolution may obviate the need to consider constitutional claims. See, *e.g.*, *United States* v. *Locke*, 471 U.S. at 92; *Ashwander* v. *TVA*, 297 U.S. 288, 347 (1936) (Brandeis, J., concurring).

We accordingly begin by addressing the pre-DEFRA tax status of appellees' Project Notes.[4]

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[4] In addition to this Court's usual practice of endeavoring to decide cases, where possible, on non-constitutional grounds, there are other reasons for beginning with an analysis of the statutory issue here. As we noted in our jurisdictional statement (at 11 n.6), a number of the pending cases involving the taxability of Project Notes are not covered by the DEFRA amendment and hence involve only the statutory issue. These cases typically involve situations where the decedent died before DEFRA's effective date, but the estate tax return was not due until after the *Haffner* decision was issued. In such circumstances, the executor is not likely to have included Project Notes on the estate tax return, so that Section 641(b)(2) of DEFRA does not apply; and, because the decedent died prior to June 19, 1984, Section 641(b)(1) of DEFRA does not apply either. Thus, this Court's resolution of the statutory issue would provide guidance to the lower courts in a significant number of cases that would otherwise be litigated. As we also pointed out in our jurisdictional statement (at 8 n.4), litigation over the statutory question has produced highly disparate results in the lower courts thus far, and further litigation could well generate a conflict in the courts of appeals. See, *e.g.*, *Netsky* v. *United States*, 652 F. Supp. 783 (E.D. Pa. 1986), appeal pending, No. 86-1616 (3d Cir.) (holding that *Haffner* was correctly decided and that DEFRA was not intended to apply retroactively to estates that had filed claims for refund before DEFRA's effective date); *Shackelford* v. *United States*, 649 F. Supp. 1347 (E.D. Va. 1986), appeal pending, No. 87-2512 (4th Cir.) (holding that *Haffner* was wrongly decided and hence not reaching DEFRA issues); *Estate of Bradford* v. *United States*, 645 F. Supp. 476 (N.D. Cal. 1986), appeal pending, No. 86-2634 (9th Cir.) (holding that *Haffner* was correctly decided, but that DEFRA applies to make Project Notes taxable). We understand that these appeals are all being held in abeyance pending this Court's resolution of this case.

I. THE HOUSING ACT OF 1937 DID NOT EXEMPT THE TESTAMENTARY TRANSFER OF PROJECT NOTES FROM THE FEDERAL ESTATE TAX

A. *General Principles Of Estate Taxation Establish That Project Notes Have Never Been Exempt From The Federal Estate Tax Because No Statutory Provision Expressly Confers Such An Exemption*

The provisions of the Internal Revenue Code[5] that govern this case are straightforward. They unambiguously provide that all property owned by a decedent at the time of his death, such as the Project Notes involved here, are subject to the estate tax. Nothing in the Housing Act of 1937 calls for a different conclusion.

1. Section 2001 of the Code imposes a tax "on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States." Computation of the estate tax begins with the "gross estate," which is defined to include "all property, real or personal, tangible or intangible, wherever situated," that is owned by the decedent, or in which he has an interest, at the time of death. I.R.C. §§ 2031, 2033. Certain property transferred by the decedent during his life is also includible in the gross estate. See, *e.g.*, I.R.C. § 2036 (transfers with retained life estate); I.R.C. § 2038 (revocable transfers). The value of the taxable estate is then determined by subtracting from the gross estate certain deductions specifically allowed by the Code. I.R.C. § 2051.

Whereas the income tax provisions of the Code have long excluded specified types of income from gross income (see, *e.g.*, I.R.C. (& Supp. III) §§ 101-

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[5] Unless otherwise noted, all statutory references are to the Internal Revenue Code (26 U.S.C.), as amended (the Code or I.R.C.).

128), the estate tax provisions do not exclude any specified types of property from the gross estate of citizens and residents. Indeed, since the estate tax was first imposed in 1916 (Revenue Act of 1916, ch. 463, §§ 200-212, 39 Stat. 777), the Internal Revenue Code has incorporated only two such exclusions—one for certain life insurance proceeds, the other for foreign real estate—and both were repealed long ago.[6] No securities of any sort have *ever* been excluded

[6] Section 402(f) of the Revenue Act of 1918, ch. 18, 40 Stat. 1098, which first included in the gross estate the proceeds of life insurance policies taken out by the decedent, excluded up to $40,000 receivable by beneficiaries other than the decedent's estate. That exclusion, however, was removed by Section 404 of the Revenue Act of 1942, ch. 619, 56 Stat. 944. Section 404 of the Revenue Act of 1934 (1934 Act), ch. 277, 48 Stat. 754, excluded from the gross estate "real property situated outside the United States." That exclusion was repealed by Section 18 of the Revenue Act of 1962, Pub. L. No. 87-834, 76 Stat. 1052. To the best of our knowledge, these two exclusions are the only ones ever established for property owned by a citizen or resident alien (if, indeed, the proceeds of life insurance can properly be characterized as "owned" by the decedent. Cf. I.R.C. § 2042 (specifically including life insurance proceeds in the gross estate)). In *Crooks* v. *Harrelson*, 282 U.S. 55 (1930), this Court held that the reference in Section 202(a) of the Revenue Act of 1916, ch. 463, 39 Stat. 777-780, to property which was "subject to distribution as part of [the decedent's] estate," precluded inclusion in the gross estate of real property in States where such property passed directly to the heir or devisee and was not administered by the estate. The language in question, however, had been eliminated by Section 302(a) of the Revenue Act of 1926, ch. 27, 44 Stat. 70, which removed any basis for the future application of the holding of *Crooks*. In sum, exclusion from the gross estate of specific types of property owned by the decedent have been extremely rare, and there have been none at all in existence for more than 20 years.

from the gross estate of citizens or resident aliens. It is thus generally true that "[t]he transfer upon death is taxable, whatsoever the character of the property transferred and to whomsoever the transfer is made." *Greiner* v. *Lewellyn*, 258 U.S. 384, 387 (1922) (holding the testamentary transfer of municipal bonds subject to federal estate tax, even though the interest paid on such bonds is generally exempt from federal income tax).

Congress, of course, has broad power to exempt property from any kind of tax. But this Court has been firm in holding that such exemptions must be explicitly provided by statute. "Exemptions from taxation," the Court has repeatedly held, "do not rest upon implication." *United States Trust Co.* v. *Helvering*, 307 U.S. 57, 60 (1939). See *Oklahoma Tax Comm'n* v. *United States*, 319 U.S. 598, 606 (1943); *United States* v. *Stewart*, 311 U.S. 60, 71 (1940); *Bank of Commerce* v. *Tennessee*, 161 U.S. 134, 146 (1896) ("There must be no doubt or ambiguity in the language used upon which the claim to the exemption is founded * * *; no implication will be indulged in for the purpose of construing the language used as giving the claim for exemption, where such claim is not founded upon the plain and clearly expressed intention of the taxing power.").

The need for careful adherence to this rule is particularly marked in the case of *transfer* taxes, such as the federal estate tax and its complement, the federal gift tax. The purpose of these taxes would be largely defeated if courts were free to discover implied exemptions for assets, such as negotiable securities, that are readily transferable and widely available to taxpayers. Wealthy individuals would then be able to circumvent the federal transfer tax regime

by temporarily converting their wealth into the exempt class of property prior to death or prior to making an inter vivos gift. This Court has always held that an intent to permit such circumvention should not lightly be imputed to Congress.

2. Consistent with these principles, it has long been settled that statutes exempting specified classes of property from "all taxation" do not immunize the transfer of that property from estate, gift, or inheritance taxes. This is because these taxes represent an excise on the privilege of transmitting property, rather than a direct tax on the property itself or on the income that it produces. See *West* v. *Oklahoma Tax Comm'n*, 334 U.S. 717, 727 (1948). Thus, for example, this Court has held that the proceeds of an insurance policy payable to a veteran's widow were includible in his gross estate, and hence subject to federal estate tax, even though the governing statute provided that the proceeds of such insurance " 'shall be exempt from all taxation.' " *United States Trust Co.* v. *Helvering*, 307 U.S. at 58 (quoting 43 Stat. 613). And in *Murdock* v. *Ward*, 178 U.S. 139, 145 (1900), the Court held a federal inheritance tax applicable to the testamentary transfer of United States bonds, notwithstanding "the clauses contained in the United States statutes exempting such bonds from state and federal taxation." [7]

[7] These cases are only two links in an unbroken chain of decisions, both in this Court and in the lower courts, holding that broad general exemptions from federal or state taxation do not apply to transfer taxes. See *Greiner* v. *Lewellyn*, *supra* (federal estate tax on testamentary transfer of municipal bonds is not "on" the bonds and hence is not inconsistent with tax exemption for interest paid thereon); *Orr* v. *Gilman*, 183 U.S. 278 (1902) (application of state inheritance tax to tax-exempt state bonds does not impair obligation of contract); *Plummer* v. *Coler*, 178 U.S. 115, 116, 134-135 (1900) (state inheritance tax on testamentary transfer of United States bonds upheld despite federal statute declaring that such bonds "shall be exempt from taxation in any form by or under state, municipal or local authority"); *Phipps* v. *Commissioner*, 91 F.2d 627, 628 (10th Cir.), cert. denied, 302 U.S. 742 (1937) (federal gift tax applicable to gift of First Liberty Loan Bonds despite statutory provision declaring that such bonds "shall be exempt • • • from all taxation, except estate or inheritance taxes, imposed by authority of the United States"); *Iglehart* v. *Commissioner*, 77 F.2d 704 (5th Cir. 1935) (Federal Farm Loan bonds includible in gross estate despite provisions in authorizing statute that bonds should be exempt from federal and state taxation); *Greene* v. *United States*, 171 F. Supp. 459 (Ct. Cl.), cert. denied, 360 U.S. 933 (1959) (Panama Canal Loan Bonds includible in gross estate although authorizing act (36 Stat. 117) provided exemption "from all taxes"); *Hamersley* v. *United States*, 16 F. Supp. 768 (Ct. Cl. 1936), cert. denied, 300 U.S. 659 (1937) (gift tax applicable to gift of U.S. Treasury Bonds of 1933, which were exempt from all taxes with exceptions that did not include gift tax). See also *Willcuts* v. *Bunn*, 282 U.S. 216 (1931) (gain on the sale of state and municipal bonds subject to the federal income tax, even though bonds themselves were assumed to be constitutionally exempt from federal taxation). See generally C. Lowndes, R. Kramer and J. McCord, *Federal Estate and Gift Taxes* § 1.1, at 1-2, § 4.7, at 44 (3d ed. 1974). Indeed, it was on the basis that such taxes were on the transfer of property, rather than on the property itself, that this Court upheld the constitutionality of the federal gift tax (*Bromley* v. *McCaughn*, 280 U.S. 124 (1929)), the federal estate tax (*New York Trust Co.* v. *Eisner*, 256 U.S. 345 (1921)), and the federal inheritance tax (*Knowlton* v. *Moore*, 178 U.S. 41 (1900)), against challenges in each instance that the tax was an unapportioned "direct tax."

This well-established rule has long been embodied in the Treasury Regulations. See Art. 13 of Regulations 80 (1937 ed.). Those Regulations explain that the estate tax "is an excise tax on the transfer of

property at death and is not a tax on the property transferred." Treas. Reg. § 20.2033-1(a). The Regulations accordingly conclude that "[v]arious statutory provisions which exempt bonds, notes, bills, and certificates of indebtedness of the Federal Government or its agencies and the interest thereon from taxation are generally not applicable to the estate tax." *Ibid.*

3. These general principles are fatal to appellees' claim that the testamentary transfer of Project Notes is exempt from estate tax. Section 5(e) of the Housing Act of 1937 provided in pertinent part that "[o]bligations, including interest thereon, issued by public housing agencies * * * *shall be exempt from all taxation* now or hereafter imposed by the United States" (50 Stat. 890 (emphasis added)). Section 5(e) provides only that Project Notes themselves, and the interest paid thereon, shall be exempt from taxation; it does not say that the *transfer* of such securities shall be immune from tax. Indeed, the italicized language of Section 5(e) is indistinguishable from the language involved in the cases just discussed, cases in which this Court refused to find an estate-tax exemption. Thus, as the district court in *Haffner* conceded (585 F. Supp. at 356-357), the text of Section 5(e) of the 1937 Act, in and of itself, cannot be read to support the exemption for which appellees contend.

B. *The Legislative History Of The Housing Act of 1937 Does Not Evince A Congressional Intent To Exempt Project Notes From The Federal Estate Tax*

Because appellees cannot base their claim on the statute's text, they necessarily rely on the contention that an intent to exempt Project Notes from estate

tax should be inferred from the legislative history of the 1937 law. That contention, of course, ignores this Court's prescription that tax exemptions must be explicit, not implied. This prescription is particularly weighty here: because there have been many billions of dollars in Project Notes in circulation at any given time, acceptance of appellees' implied tax exemption argument would permit individuals to go far toward frustrating the estate tax altogether.[8] In any event, appellees' contentions are based on an incomplete and mistaken understanding of the legislative history. Viewed in the proper context, the "ambiguous tidbits" (727 F.2d at 920 (Posner, J., dissenting)) of legislative history upon which appellees rely provide no support for the view that Congress intended to exempt Project Notes from estate taxation, much less furnish the compelling evidence that would be needed to establish such an extraordinary exemption in the absence of a statute expressly providing therefor.

1. Neither the *Haffner* court nor appellees have pointed to any instance, apart from the present context, in which statutory language like that contained in Section 5(e) of the 1937 Act—language stating simply that securities "shall be exempt from all taxation"—has been held to exempt the transfer of such securities from estate tax. We for our part are aware of none. Rather, appellees premise their claim for tax exemption principally upon comparison of Section 5(e) with another section of the 1937 Act,

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[8] For example, in *Shackelford* v. *United States*, *supra*, the estate is seeking a refund of more than $22.5 million in estate taxes attributable to the inclusion of Project Notes in the taxable estate (649 F. Supp. at 1348).

Section 20(b), which does not concern Project Notes at all.

a. Section 20(b) of the 1937 Act, which has long since disappeared from the statute, concerned obligations issued by the United States Housing Authority, a federal instrumentality created by that Act. Section 20(b) provided that "[s]uch obligations shall be exempt, both as to principal and to interest, from all taxation (*except surtaxes, estate, inheritance, and gift taxes*) now or hereafter imposed by the United States or by any State * * *" (50 Stat. 898 (emphasis added)). Appellees contend that the italicized parenthetical phrase in Section 20(b) shows that the 1937 Congress knew how to exclude estate taxes from a generalized tax exemption when it wanted to do so. The absence of such a parenthetical phrase from Section 5(e), appellees therefore conclude, proves that Congress must have intended Section 5(e) to make Project Notes exempt from *all* federal taxes, including estate taxes.

This reasoning is fallacious because it ignores the completely different purposes of the two Sections of the 1937 Act. Section 5(e) created an exemption from federal taxation for Project Notes issued by state and local agencies. Section 20(b), by contrast, created a more limited exemption from federal taxation, as well as an exemption from state taxation, for the obligations of a federal agency. These differences in purpose fully explain the different language used by the 1937 Congress in the two Sections, as an examination of the statute as a whole makes clear.

The stated purpose of the Housing Act of 1937, often called the Wagner Housing Act, was to help the States "remedy the unsafe and insanitary housing conditions and the acute shortage of decent, safe,

and sanitary dwellings for families of low income" (50 Stat. 888).[9] Section 3 of the Act established the United States Housing Authority, a federal instrumentality designed to assist the States in this endeavor (50 Sat. 889).[10] Section 5(e) established the tax-exempt status of the Authority, providing that its income and property were to be exempt from both state and federal taxation. Section 5(e) also set forth the exemption at issue here—an exemption from federal taxation for the obligations and income of the state and local housing agencies[11] that would be working with the Authority in furthering the statute's housing-improvement goals. Section 5(e) reads in full as follows (50 Stat. 890):

> The Authority, including but not limited to its franchise, capital, reserves, surplus, loans, in-

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[9] T. McDonnell, *The Wagner Housing Act, A Case Study of the Legislative Process* (1957). The study contains a detailed account of "[t]he long and complicated struggle for the enactment of this law" (*id.* at vii).

[10] See generally Tretter, *Public Housing Finance*, 54 Harv. L. Rev. 1325 (1941). The assistance to be provided by the Authority was principally set forth in Section 9 ("Loans for Low-Rent-Housing and Slum-Clearance Projects"), Section 10 ("Annual Contributions in Assistance of Low Rentals"), and Section 11 ("Capital Grants in Assistance of Low Rentals") of the 1937 Act. The Authority ceased to exist as a separate body in 1947, though it was recreated in 1967; its functions are now performed by the Department of Housing and Urban Development.

[11] Section 2(11) of the 1937 Act defined "public housing agency" to mean "any State, county, municipality, or other government entity or public body * * * authorized to engage in the development or administration of low-rent housing or slum clearance" (50 Stat. 889).

> come, assets, and property of any kind, shall be exempt from all taxation now or hereafter imposed by the United States or by any State, county, municipality, or local taxing authority. Obligations, including interest thereon, issued by public housing agencies in connection with low-rent-housing or slum-clearance projects, and the income derived by such agencies from such projects, shall be exempt from all taxation now or hereafter imposed by the United States.

The federal tax exemption set forth in the second sentence of Section 5(e) thus covered the income derived by public housing agencies from housing projects, the obligations ("Project Notes") issued by those agencies, and the interest paid thereon.[12] This exemption, of course, was important to those agencies' successful operation. In particular, tax exemption for the interest paid on Project Notes enhanced the marketability of those obligations, putting them on a par with other state and municipal obligations, the interest on which was generally exempt from federal income tax . Of course, there was no intent expressed by Congress—and nothing on the face of the

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[12] It was necessary for the 1937 Act to include an explicit exemption for the "interest thereon," even though interest on "obligations of a State, Territory, or any political subdivision thereof" was generally exempt (then as now) from federal income tax. See Revenue Act of 1936, ch. 690, § 22(b)(4), 49 Stat. 1657. This was because many public housing agencies at that time would not have been considered "political subdivisions" within the meaning of the general exemption in the Revenue Act. See *Haffner* v. *United States*, 757 F.2d at 922 (Posner, J., dissenting). See also Tretter, *supra*, 54 Harv. L. Rev. at 1326 n.4; *Commissioner* v. *Shamberg's Estate*, 144 F.2d 998 (2d Cir. 1944), cert. denied, 323 U.S. 792 (1945).

statute to support the proposition—that Project Notes should be treated *more* favorably than other state and municipal obligations, the transfer of which for many years had been subject to federal estate and gift tax. Rather, the formula that Congress used in Section 5(e)—"exempt from all taxation"—was the formula generally understood and routinely used to confer an exemption from all direct taxes, but not from transfer taxes.

Section 20(b) of the 1937 Act, on the other hand, was addressed to a different matter—the treatment of the obligations of the United States Housing Authority. Section 20(a) authorized the Authority to issue obligations, such as notes or bonds, to obtain funds for the purposes of the Act. Section 20(b) then delineated the scope of the tax exemption for these federal obligations (50 Stat. 898 (emphasis added)):

> Such obligations shall be exempt, both as to principal and interest, from all taxation (*except surtaxes, estate, inheritance, and gift taxes*) now or hereafter imposed by the United States or by any State, county, municipality, or local taxing authority.

Congress inserted the parenthetical phrase into Section 20(b)—a phrase that, as appellees emphasize, is absent from Section 5(e)—because it wished to make clear that interest on federal Housing Authority obligations, unlike interest on state and local Project Notes, was to be subject to the federal income tax "surtax." From 1913 until 1954, the income tax was composed of two parts. There was a so-called "normal tax" on net income, usually at a fixed rate. There was also a "surtax," at graduated rates, on a differently-computed amount of income, referred to

as "surtax net income."[13] In 1937, the normal tax was levied at a rate of 4% on an individual's net income, and the surtax was levied at graduated rates of up to 75% on an individual's "surtax net income." See Revenue Act of 1936, ch. 690, §§ 11, 12, 49 Stat. 1653.

Of particular relevance here, the tax law as it existed in 1937 provided that interest on federal obligations was exempt from income tax "only if and to the extent provided in the respective Acts authorizing the issue thereof." Revenue Act of 1936, ch. 690, § 22 (b)(4), 49 Stat. 1657. Most of those authorizing Acts provided that such interest income was exempt from the normal tax, but not from the surtax, which generally applied to higher-income taxpayers.[14] Con-

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[13] For example, Section 25(a) of the Revenue Act of 1936, ch. 690, 49 Stat. 1662, listed a category of "credits for normal tax only" that were "allowed for the purpose of the normal tax, but not for the surtax." These included an "earned income credit" and, prior to 1936, also included a credit for corporate dividends (see Section 25(a)(1) of the Revenue Act of 1934, ch. 277, 48 Stat. 692)).

[14] Congress acted in 1941 to provide a uniform rule for the taxability of interest on federal obligations. Section 4 of the Public Debt Act of 1941, ch. 7, 55 Stat. 9, generally provided that interest on obligations of the United States and its instrumentalities should be fully subject to the federal income tax, and it amended existing authorizing statutes to that effect. Prior to 1941, however, there was a patchwork of different approches. Most federal obligations were exempted only from the normal tax, and not from the surtax. But there were several variations from this pattern. For example, Section 7 of the Second Liberty Bond Act of 1917, ch. 56, 40 Stat. 291, exempted the obligations authorized thereunder from the normal tax only for the first $5,000 face amount of such obligations held by the taxpayer. And Section 8 of the Banking Act of 1933, ch. 89, 48 Stat. 168, amended the Federal

gress determined in 1937 that the tax treatment of Federal Housing Authority obligations should follow this common pattern. To achieve that objective, Congress incorporated in Section 20(b) a proviso stating that "surtaxes" were not within the statutory exemption. Congress, of course, had no need to incorporate such a proviso in Section 5(e), since Congress intended that state and local Project Notes should be exempted altogether from the federal income tax, both from the normal tax and from the surtax.

b. What we have said thus far makes clear that no inference supportive of appellees' position can be drawn from the presence in Section 20(b), without more, of a parenthetical phrase containing the words "except surtaxes." Appellees' argument thus reduces to the contention that Congress could have closed the Section 20(b) parenthesis immediately after the word "surtaxes," and that it had no need to include "estate, inheritance, and gift taxes" therein. As we have previously explained (pages 18-20, *supra*), generalized exemptions from "all taxation" have typically been read to include an *automatic* proviso putting transfer taxes outside their scope. Thus, appellees' argument runs, Congress had no reason to include in Section 20(b) an explicit proviso to that effect, unless it meant to qualify, by negative implication, the meaning of the generalized exemption in Section 5(e). In essence, appellees argue that, un-

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Reserve Act to exempt from both the normal tax and the surtax the Federal Deposit Insurance Corporation obligations authorized to be issued thereunder. A tabular listing of the federal obligations outstanding in 1941 with a summary of the applicable exemption provisions consumes six pages (1144-1149) of Volume 1 of the 1941 edition of the CCH Standard Federal Tax Service.

less the words "estate, inheritance, and gift taxes" in Section 20(b) are to be deemed surplusage, the phrase "exempt from all taxation" in Section 5(e) must be read, in defiance of its ordinary meaning, to incorporate an exemption for transfer taxes.

Appellees' argument—that the well established meaning of one statutory provision should be ignored because of an inference drawn from a completely unrelated statutory provision—would be strained in almost any circumstances. The short answer to their argument, however, is that there is a perfectly logical reason why Congress, having found it necessary to insert in Section 20(b) a proviso covering surtaxes, went on to specify the other taxes that were likewise meant to be outside the exemption's scope. Once an exemption has been drafted specifically to exclude one type of tax, it makes sense for the draftsman to forestall an *expressio unius est exclusio alterius* argument by specifically excluding *all* the taxes not covered thereby. To put it concretely, if the parenthetical phrase in Section 20(b) had simply said "except surtaxes," it would have opened the door for a litigant to argue that the Section 20(b) exemption covered all other taxes, including transfer taxes, in defiance of Congress's intent. See, *e.g.*, *Phipps* v. *Commissioner*, 91 F.2d 627, 631-632 (10th Cir.), cert. denied, 302 U.S. 742 (1937) (Phillips, J., dissenting) (arguing that a statutory exemption from "all taxation, except estate or inheritance taxes," should be read to exempt property from gift taxes, on *expressio unius est exclusio alterius* theory). In short, once Congress found it necessary to have a proviso in Section 20(b) at all, it wisely drafted the proviso to exclude *all* the taxes meant to be excluded, thereby heading off any possible misconstruction.

The reference in Section 20(b) to "estate, inheritance, and gift taxes" thus followed naturally as a matter of sensible draftsmanship from the need to refer to "surtaxes"; the two exclusions, one might say, are an inseparable couple. This mode of draftsmanship was in fact quite common at the time. Numerous statutes designed to exempt the interest paid on federal obligations from the normal income tax, but not from the surtax, used the same formula as Section 20(b), providing that the obligations at issue "shall be exempt, both as to principal and interest, from all taxation (except surtaxes, estate, inheritance, and gift taxes)." See, *e.g.* Home Owners Loan Act of 1933, ch. 64, § 4(c), 48 Stat. 129.[15] And it is significant that such explicit exceptions for estate, inheritance and gift taxes largely disappeared from statutes enacted after 1941, when Congress made the interest on federal obligations fully subject to the federal income tax, and hence eliminated the need for any "except surtaxes" provisos. See note 14, *supra*.

In sum, there is no basis for drawing any inference about the proper interpretation of Section 5(e) by referring to the text of Section 20(b). The two sections are addressed to entirely different subjects, and there is no reason why inferences about the one should be drawn from the text of the other. See, *e.g.*, *Tooahnippah* v. *Hickel*, 397 U.S. 598, 606 (1970); *Nacirema Co.* v. *Johnson*, 396 U.S. 212, 222 & n.18 (1969). This is particularly so in light of the fact

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[15] See also, *e.g.*, War Finance Corporation Act of 1918, ch. 45, § 16, 40 Stat. 511; Reconstruction Finance Corporation Act of 1932, ch. 8, § 10, 47 Stat. 9; Federal Home Loan Bank Act of 1932, ch. 522, § 13, 47 Stat. 735; Farm Credit Act of 1933, ch. 98, § 63, 48 Stat. 267.

that the two provisions were not drafted contemporaneously; Section 20(b) appeared in the bill introduced in 1936, and Section 5(e) appeared for the first time in 1937.[16] Each section was drafted using the language commonly used by Congress to achieve the desired legislative purpose. To twist the language of Section 5(e) to give it a meaning unlike that given to any other statute using the same language would frustrate Congress's intent, not further it.[17]

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[16] Section 20(b) appeared as Section 21(b) of a bill introduced by Senator Wagner in 1936 (S. 4424, 74th Cong., 2d Sess. (1936), *reprinted at* T. McDonnell, *supra*, at 428, 440). Section 5(g) of that bill was the analogue to what ultimately became Section 5(e) of the 1937 Act. But Section 5(g) contained only the first sentence of that latter provision, addressing the tax-exempt status of the United States Housing Authority; it did not contain any reference to Project Notes.

[17] The district court in *Haffner* justified its method of divining congressional intent by placing great weight (585 F. Supp. at 359-360) on a court of appeals decision, *Jandorf's Estate* v. *Commissioner*, 171 F.2d 464 (2d Cir. 1948), which had recognized an exemption from federal estate tax for certain bonds held by non-resident aliens. The court's reliance on *Jandorf's Estate* was misplaced, however, for that case is distinguishable on several grounds. *Jandorf's Estate* involved a special provision relating to ownership by non-resident aliens, which the court compared to the provision covering bonds owned by domestic investors. In reaching its conclusion that this provision exempted the bonds in question from estate tax when held by foreign investors, the court relied quite heavily on the fact that the Treasury Regulations had recognized such an estate tax exemption since 1928 (see 171 F.2d at 467). Indeed, the *Jandorf* litigation focused upon whether the change in taxability of interest on federal obligations effected by the Public Debt of 1941 (see note 14, *supra*) justified a change in Treasury's position with respect to estate taxation of bonds issued after March 4, 1941; the government did not contest the taxpayer's invocation of an estate

2. The district court in *Haffner* also relied (585 F. Supp. at 359) on a statement made by Senator Walsh during the debate on the bill that was to become the Housing Act of 1937. Toward the end of a lengthy speech (81 Cong. Rec. 8076-8086 (1937)), parts of which were critical of the bill, Senator Walsh made the following statement (*id.* at 8085):

> Obligations, including interest thereon, issued by public housing agencies, and income derived by such agencies on such projects are to be exempt from all taxation now or hereafter imposed by the United States. In other words, the bill gives the public housing agencies the right to issue tax-exempt bonds, which means they are free from income tax, surtax, estate, gift and inheritance taxes.

For two reasons, this statement cannot be regarded as persuasive evidence that Congress, contrary to the

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tax exemption for bonds issued prior to that date. See *id.* at 464-465. The court also adverted to legislative history showing that Congress had specifically considered the possibility of granting an estate tax exemption (*id.* at 465, 466 & nn. 1, 2). Thus, *Jandorf's Estate* provides no basis for inferring an estate tax exemption here, since there is no comparable contemporaneous evidence indicating that Congress intended to enact, or even considered, an estate tax exemption for Project Notes. Cf. *Greene* v. *United States*, 171 F. Supp. at 461.

It should be noted that Congress acted quickly to overturn the exemption recognized in *Jandorf's Estate*. Section 604 of the Revenue Act of 1951, ch. 521, 65 Stat. 566, provided specifically for the prospective inclusion of federal bonds in the taxable estates of non-resident aliens. Congress explained that such obligations "are and should be subject to the principle of *Murdock* v. *Ward*, and *Plummer* v. *Coler*." H.R. Rep. 586, 82d Cong., 1st Sess. 139 (1951); S. Rep. 781, 82d Cong., 2d Sess. Pt. 2, at 107 (1951).

import of Section 5(e)'s language, intended to establish an unprecedented estate tax exemption for Project Notes.

First, Senator Walsh did not directly state that Project Notes would have the unusual tax exemption for which appellees contend. What he said was that state housing agencies could "issue tax-exempt bonds, *which means* they are free from income tax, surtax, estate, gift and inheritance taxes" (81 Cong. Rec. 8085 (1937) (emphasis added)). The logical construction of this statement is that Senator Walsh was saying that Project Notes would have the same characteristics as other tax-exempt bonds; the appositional phrase beginning with "which means" was simply an attempt to describe those characteristics. Of course, the appositional phrase does not correctly describe the characteristics of tax-exempt bonds—*i.e.*, bonds "exempt from all taxation"—because such bonds ordinarily are not exempt from estate, inheritance, and gift taxes. One can only speculate, of course, about the source of the Senator's error, which may have been caused by a lack of familiarity with the principles enunciated in this Court's decisions. Whatever the source, however, Senator Walsh's statement is most logically viewed, as Judge Posner concluded in his *Haffner* dissent (727 F.2d at 922), as demonstrating a "misunderst[anding of] the well-settled meaning of 'tax-exempt bonds.'"

In any event, even if Senator Walsh actually had said that Project Notes were intended to have an unprecedented exemption from estate taxation, there is no reason why an isolated statement made by a single Senator on the floor should override the well-settled meaning of the words that Congress placed in the statute. The sponsor of the legislation was Senator Wagner, and it is not apparent why Senator Walsh should be regarded as an authoritative expositor of its meaning.[18] Indeed, although Senator Walsh did vote for the Housing Act of 1937, he was a vocal opponent of some of its provisions, particularly government financing of home building. See 80 Cong. Rec. 9558 (1936); 81 Cong. Rec. 8079, 8090-8091 (1937); see also T. McDonnell, *supra*, at 184-185, 333-338. It is well established that "[t]he remarks of a single legislator, even the sponsor, are not controlling in analyzing legislative history." *Chrysler Corp.* v. *Brown*, 441 U.S. 281, 311 (1979). See *Weinberger* v. *Rossi*, 456 U.S. 25, 35 (1982); *Consumer Products Safety Comm'n* v. *GTE Sylvania, Inc.*, 447 U.S. 102, 118 (1980). No other statement in the congressional debates, and no statement in the committee reports, provides a shred of support for the proposition that Section 5(e) was meant to grant Project Notes a degree of exemption from federal

[18] The district court in *Haffner* characterized Senator Walsh as a "sponsor" of the legislation (585 F. Supp. at 359 n.5), but a printed copy of the bill does not list him as a sponsor. Senator Walsh was the Chairman of the Senate Committee on Education and Labor in 1935, and in that capacity he did preside over hearings on the housing bill that was first introduced into Congress. During these hearings, Senator Walsh "provided for the testimony of those opposed to the bill and those representatives of organizations who wished to present substitute plans" (T. McDonnell, *supra*, at 105 (footnote omitted)). The bill introduced in 1935, however, was never reported out of committee. By 1937, when the bill that eventually was enacted was introduced, Senator Walsh had been replaced as chairman of the committee by Senator Black (*id.* at 221), although Senator Walsh did subsequently serve as acting chairman at times, either because of Senator Black's illness (*id.* at 317) or, later, because he had been appointed to the Supreme Court (*id.* at 390 n.3).

taxation greater than that accorded to all other state and local obligations. In these circumstances, Senator Walsh's ambiguous and isolated remark carries little weight when arrayed against the clear import of the statutory language chosen by Congress.

3. The third and final "ambiguous tidbit" relied upon by the *Haffner* courts was Congress's failure to enact a different version of the bill that ultimately became the Housing Act of 1937. During the 1937 hearings on the Wagner bill, Secretary of the Interior Ickes submitted and supported a version "differ[ing] in many substantive respects from the Wagner bill" (585 F. Supp. at 358). The Ickes proposal contained a variant of Section 5(e) that was explicit in excepting estate taxes from the federal tax exemption for Project Notes. Most of the changes proposed by Secretary Ickes were never reported out of Committee.

The Committee's decision not to report out Secretary Ickes' version of the bill plainly creates no inference that Congress meant to exempt Project Notes from estate taxation. The Ickes version differed from the Wagner bill in many important respects, and there is no reason to believe that the variant draftsmanship of Section 5(e) entered into the Committee's decision at all. Indeed, the statement submitted to the Committee by Secretary Ickes discussing the differences between his bill and the Wagner bill made no mention of the differences in language between the two versions of Section 5(e), and the Secretary certainly did not state that the Wagner bill would have the differential effect of exempting Project Notes from all federal transfer taxes. *To Create a United States Housing Authority: Hearings on S. 1685 Before the Senate Comm. on Education and Labor*, 75th Cong., 1st Sess. 49-55 (1937). Moreover,

as Judge Posner pointed out in his *Haffner* dissent (757 F.2d at 922), there is no indication that the existence of the Ickes version was even known to most members of Congress outside the Senate Committee. Thus, the Committee's failure to adopt the Ickes version is entirely irrelevant in answering the question presented here.

4. In view of this Court's repeated admonitions that "[e]xceptions from taxation do not rest upon implication" (*United States Trust Co.* v. *Helvering*, 307 U.S. at 60), the ambiguous legislative evidence on which appellees rely is woefully inadequate to create the estate tax exemption that they posit, an exemption that concededly cannot be found in the language of Section 5(e) itself. This conclusion is supported, not only by sound principles of statutory construction, but also by common sense. The *Haffner* courts' discovery, in the early 1980s, of an estate tax exemption that had gone unclaimed by taxpayers, unacknowledged by the IRS, and unrecognized by the courts for some 45 years, is most implausible. Generally speaking, tax exemptions of such magnitude do not lie dormant for such an extended period of time, invisible to the ever-watchful eyes of the private tax bar. Indeed, a 1979 study by the Tax Section of the ABA examined the Housing Act of 1937 in great detail, and it discerned no such uniquely favorable estate-tax treatment for Project Notes. See Committee on Tax Exempt Financing, Section of Taxation, ABA, *Report on the Tax Provisions of the United States Housing Act of 1937: Beyond the Looking Glass*, 33 Tax Lawyer 71 (1979). The district court thus clearly erred in postulating an unprecedented exemption for those securities.[19]

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[19] In any event, subsequent legislation has dissipated any possible inference of an estate tax exemption for Project

II. SECTION 641 OF THE DEFICIT REDUCTION ACT OF 1984 SUBJECTS APPELLEES' PROJECT NOTES TO THE FEDERAL ESTATE TAX AND IT DOES NOT VIOLATE THE FIFTH AMENDMENT

Within three months of the district court's decision in *Haffner*, Congress acted to overturn that decision in the Deficit Reduction Act of 1984 (DEFRA), Pub. L. No. 98-369, 98 Stat. 494. Section 641 of DEFRA, 98 Stat. 939, entitled "Clarification of Treatment," provides:

> *General Rule.*—Nothing in any provision of law exempting any property (or interest therein) from taxation shall exempt the transfer of such property (or interest therein) from Federal estate, gift, and generation-skipping transfer taxes.

Notes that could be drawn from the Housing Act of 1937. That Act has been amended on many occasions. For example, Section 304(h) of the Housing Act of 1949 (1949 Act), ch. 338, 63 Stat. 427, completely rewrote Section 20 of the 1937 Act and, in particular, eliminated Section 20(b), which serves as the basis for appellees' effort to imply an estate tax exemption in Section 5(e). Subsequently, Section 201(a) of the Housing and Community Development Act of 1974, Pub. L. No. 93-383, 88 Stat. 653, again rewrote and made changes in the statute; the 1974 version likewise contained no provision analogous to Section 20(b) of the 1937 Act. There is no reason whatsoever to believe that the legislators that enacted the 1949 and 1974 Acts intended thereby to carry forward an implied estate tax exemption for Project Notes when it had never been suggested that Project Notes had ever had any greater exemption than other state or municipal obligations. Thus, there is no conceivable basis for applying such an exemption to appellees' Project Notes, all of which were issued in the 1980s. See Wells Fargo Complaint ¶ 5; Rosenberg Complaint ¶ 7.

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Section 641(b) delineated the coverage of this rule. Section 641(b)(1) makes it applicable to the estates of decedents dying, and to gifts and transfers made, on or after June 19, 1984. In addition, Section 641(b)(2) provides (98 Stat. 939):

> *Treatment of certain transfers treated as taxable.*—The provisions of subsection (a) shall also apply in the case of any transfer of property (or interest therein) if at any time there was filed an estate or gift tax return showing such transfer as subject to Federal estate or gift tax.

Section 641(b)(3) provides that "[n]o inference shall arise from paragraphs (1) and (2) that any transfer of property * * * before June 19, 1984, is exempt from federal estate and gift taxes" (98 Stat. 939).

It is undisputed in these cases that the federal estate tax returns filed by appellees showed the Project Notes owned by the decedents as subject to the estate tax (see J.S. App. 1a, 6a). As the district court correctly determined (*id.* at 5a-8a), therefore, the plain language of Section 641(b)(2) dictates the conclusion that Congress intended the provisions of Section 641(a) to prevent taxpayers like appellees from bringing refund suits based on the contention that the Project Notes owned by their decedents should not have been included in the gross estate.[20]

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[20] Appellee Wells Fargo Bank, disputes the proposition that DEFRA applies to it (Mem. in Response to J.S. at 17-19). It contends that the phrase if "at any time" in Section 641(b)(2) means "at any time after June 19, 1984" (*id.* at 19). It offers no support for this remarkable suggestion, which, if correct, would come close to making Section 641(b)(2) a dead letter. If anything beyond the plain lan-

The district court erred, however, in holding that application of Section 641(b)(2) here would be unconstitutional, as violative of either of the Due Process Clause or of the equal protection component of the Fifth Amendment.

A. *The Application Of Section 641 To Appellees Does Not Violate The Due Process Clause*

The district court clearly erred in concluding that Section 641(b)(2) of DEFRA violates the Due Process Clause because it prevents taxpayers from seeking a refund of estate taxes on the theory propounded by the *Haffner* court. It is well established that the mere fact that legislation has some retroactive application does not establish a constitutional violation. As this Court stated in *Pension Benefit Guar. Corp.* v. *R.A. Gray & Co.*, 467 U.S. 717, 729 (1984):

> [T]he strong deference accorded legislation in the field of national economic policy is no less applicable when that legislation is applied retroactively. Provided that the retroactive application of a statute is supported by a legitimate legislative purpose furthered by rational means, judgments about the wisdom of such legislation remain within the exclusive province of the legislative and executive branches.

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guage of the statute is needed to refute this contention, it is provided by the Joint Committee's explanation of the statute's effective date, which states: "The provisions also apply to transfers occurring before June 19, 1984, if the transfers previously were reported as subject to Federal transfer tax. No claims for refund may be filed, therefore, with respect to such transfers." Staff of the Joint Comm. on Taxation, 98th Cong., 2d Sess., *General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984*, at 972 (Joint Comm. Print 1984).

These principles apply with full force to the tax laws; indeed, tax legislation regularly contains some element of retroactivity. See, *e.g.*, *United States* v. *Darusmont*, 449 U.S. 292, 296-299 (1981); *Welch* v. *Henry*, 305 U.S. 134, 146-150 (1938); *Milliken* v. *United States*, 283 U.S. 15, 24 (1931). The retroactive application of a tax is unconstitutional only if it is found to be "harsh and oppressive." *United States* v. *Hemme*, No. 84-1944 (June 3, 1986); *Welch* v. *Henry*, 305 U.S. at 147.

The district court did not point, and it could not point, to anything suggesting that the retroactive application of Section 641 is "harsh and oppressive." To the contrary, the statute is designed simply to avoid giving taxpayers a windfall benefit as result of a judicial decision that discerned a previously-unrecognized tax exemption with major revenue implications—an exemption that Congress plainly thought should not be available. And even with respect to that narrow objective, the scope of the statute's retroactive application is confined to those taxpayers who had already reported the Project Notes as taxable on a tax return filed with the IRS. Hence, the statute does not affect any taxpayer who may have invested prior to June 19, 1984, on the assumption that Project Notes were immune from estate and gift taxation. The statute therefore upsets no settled expectations; it does no more than restore the *status quo ante* the district court's decision in *Haffner*. There is nothing "harsh [or] oppressive" about a statute that merely holds a taxpayer to his own treatment of items on a tax return that he himself prepared.[21]

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[21] Indeed, it is questionable whether a statute that does no more than clarify the law in accordance with the longstanding view of the Treasury Department and, apparently, tax practi-

The district court's reliance on *Untermyer* v. *Anderson*, 276 U.S. 440 (1928), is quite mistaken. As the district court itself recognized (J.S. App. 12a), *Untermyer* stands, at most, for the proposition that a "wholly new tax" cannot be imposed retroactively on transactions completed before the new tax is enacted. See, *e.g.*, *United States* v. *Hemme*, slip op. 9 (distinguishing *Untermyer*); *United States* v. *Darusmont*, 449 U.S. at 299-300 (same); *Milliken* v. *United States*, 283 U.S. at 21 (same).[22] The district court's assertion (J.S. App. 12a) that Section 641 of DEFRA "amounts to" the imposition of a "wholly new tax" is completely unsupportable. The fact is that DEFRA made at most a slight change (and we believe that it made no change) in the existing estate tax regime. The decedents here knew that the transfer of their estates would be subject to estate tax, and they knew that the value of property interests held at death generally would be includible in the gross estate. See I.R.C. §§ 2001, 2031 and 2033. A legislative alteration of this scheme to eliminate a supposed exemption for a particular type of property—an exemption that was completely unrecognized at the time of the decedents' deaths—is not the establishment of a "wholly new tax." Rather, it is precisely the type of adjustment in the existing tax structure that this Court repeatedly has held may be effected retroactively without violating any due process rights.

Even if one assumes that the decedents here would have acted differently had they known that Congress would reject the exemption discovered by the *Haffner* courts, which is most unlikely since there is no reason to believe that the decedents even considered the possibility that there was such an exemption, *Untermyer* provides no basis for a due process attack. The possibility that Congress will make a

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tioners, can be said to operate "retroactively" at all. See *Commissioner* v. *Fisher*, 327 U.S. 512, 514, 515 (1946); *Commissioner* v. *Wheeler*, 324 U.S. 542, 545 (1945). What the statute does is to prevent taxpayers from obtaining a *refund* of taxes already paid, where those taxes were paid on the basis of what was at the time the universal understanding of the law, and one that Congress subsequently ratified. The only "retroactive" effect of the statute is to prevent the taxpayer from changing his position and arguing that, prior to the clarification by Congress, the law was the opposite of what the taxpayer understood it to be when he filed his return.

[22] Following this Court's lead, the courts of appeals, if not questioning the continuing validity of *Untermyer*, have uniformly viewed it as applying only to the retroactive application of a wholly new tax. See, *e.g.*, *Fein* v. *United States*, 730 F.2d 1211, 1213-1214 (8th Cir.), cert. denied, 469 U.S. 858 (1984) ("the modern trend of decisions has uniformly been to limit" *Untermyer* to the "narrow situation" there involved); *Estate of Ceppi* v. *Commissioner*, 698 F.2d 17, 21 (1st Cir.), cert. denied, 462 U.S. 1120 (1983) (collecting cases and concluding that, in light of this Court's subsequent decision in *Milliken*, "*Untermyer* at best remains good law only for the proposition that a wholly new gift tax cannot be applied retroactively"); *Westwick* v. *Commissioner*, 636 F.2d 291, 292 (10th Cir. 1980) (limiting *Untermyer* to "wholly new types of taxes"); *Buttke* v. *Commissioner*, 625 F.2d 202, 203 (8th Cir. 1980), cert. denied, 450 U.S. 982 (1981) (reading *Untermyer* to bar "retroactive application of a wholly new tax"); *Sidney* v. *Commissioner*, 273 F.2d 928, 932 (2d Cir. 1960) (Friendly, J.) ("If *Untermyer* remains authority at all, it is so only for the particular situation of a wholly new type of tax."). See generally Hochman, *The Supreme Court and the Constitutionality of Retroactive Legislation*, 73 Harv. L. Rev. 692 (1960); Ballard, *Retroactive Federal Taxation*, 48 Harv. L. Rev. 592 (1935).

change in applicable tax exemptions is one that is always present in our system, particularly since Congress now adjusts the revenue laws almost annually. As Judge Learned Hand observed shortly after *Untermyer* was decided, the taxpayer "must be prepared for such possibilities, the [estate tax] system already being in place" (*Cohan* v. *Commissioner*, 39 F.2d 540, 545 (2d Cir. 1930)).

The district court's assertion that these cases "present far more egregious factual situations than *Untermyer*" (J.S. App. 13a) is similarly untenable. This assertion appears to rest on the fact that the taxpayer in *Untermyer*, because legislation to enact a gift tax was pending in Congress at the time he made his gift, could have anticipated that a gift tax would be enacted. The decedents here, by contrast, "could not have foreseen the enactment * * * of DEFRA's provisions taxing the Project Notes" (J.S. App. 14a). It has never been suggested, however, that Congress's power to enact retroactive tax legislation is limited to laws affecting the period during which the legislation is pending; such a rule would seriously curtail Congress's legislative authority. In any event, to the extent that foreseeability or "personal notice" may sometimes be material in assessing the constitutionality of a retroactive tax (see *United States* v. *Darusmont*, 449 U.S. at 299), it is completely irrelevant here. For while it is true that the instant decedents, prior to their death, could not have foreseen the enactment of DEFRA, it is also evident that they did not foresee the opinion in *Haffner* either—their executors, after all, included the Project Notes in their taxable estates. In assessing whether the effect of Section 641 is "harsh and oppressive," therefore, it is irrelevant that these decedents could

not have anticipated Congress's decision to *repeal* the supposed estate tax exemption for Project Notes, since these decedents manifested no awareness that such an exemption existed to begin with. Indeed, the published position of the IRS at the time was that Project Notes were includible in the gross estate. Rev. Rul. 81-63, 1981-1 C.B. 455.

The power of Congress to act retroactively to correct judicial interpretations of the Internal Revenue Code that it views as erroneous is one that must exist if Congress is to protect the public fisc. Indeed, in another Section of DEFRA, Congress similarly acted to forestall refund suits, where such suits would have produced windfalls for taxpayers based on an intervening and unanticipated court decision. Pub. L. No. 98-369, § 2662(g), 98 Stat. 1160 (clarifying law to the effect that employer contributions to "salary reduction plans" had to be included in the social security (FICA) wage base). The courts have unanimously upheld the validity of Section 2662(g) against constitutional objections of the sort raised by appellees here. See, *e.g.*, *New England Baptist Hospital* v. *United States*, 807 F.2d 280 (1st Cir. 1986), *Canisius College* v. *United States*, 799 F.2d 18 (2d Cir. 1986), cert. denied, No. 86-1187 (Apr. 20, 1987); *Temple University* v. *United States*, 769 F.2d 126 (3d Cir. 1985), cert. denied, No. 85-1401 (June 16, 1986). The First Circuit explained why the retroactive application of the statute raised no due process concerns as follows (807 F.2d at 285):

> Congress' 1984 enactment ratified longstanding Treasury policy. The amendments, therefore, brought the tax code in line with the [taxpayer's] expectations at the time it withheld and paid the taxes. Legislation that merely validates

> a prior tax collection is less likely to violate the principles of due process than legislation that retroactively imposes a tax that had not been anticipated.

This reasoning is equally applicable here.

Finally, even if the decedents had entertained a subjective expectation that their Project Notes would be immune from estate tax, that expectation would not have been reasonable since, as we have explained, there was little basis for that view before (or, for that matter, after) the district court's decision in *Haffner*. Faced with the decision in *Haffner*, it was not "harsh and oppressive" for Congress to correct the error it perceived and close the enormous loophole that the *Haffner* court opened, thereby implementing the congressional intent that Project Notes be included in the gross estate just like other forms of property. Simply put, the Due Process Clause does not confer on every taxpayer a constitutional right to reap a windfall from a single erroneous court decision.

B. *The Application of Section 641 To Appellees Does Not Violate The Equal Protection Component Of The Fifth Amendment*

The district court's holding that Section 641(b)(2) of DEFRA denies to appellees the equal protection of the laws is equally unsupportable. It is well established that a statutory classification is valid so long as it "bear[s] a rational relation to a legitimate governmental purpose." *Regan* v. *Taxation With Representation*, 461 U.S. 540, 547 (1983). And this Court has noted that the legislature is accorded "especially broad latitude in creating classifications and distinctions in tax statutes" (*ibid.*). In the case of

such tax classifications " 'the presumption of constitutionality can be overborne only by the most explicit demonstration that [the] classification is a hostile and oppressive discrimination against particular persons and classes. The burden is on the one attacking the legislative arrangement to negative every conceivable basis which might support it.' " *Id.* at 547-548 (quoting *Madden* v. *Kentucky*, 309 U.S. 83, 87-88 (1940)). Appellees plainly did not meet that burden here; there can be no doubt that the distinction drawn in Section 641(b) of DEFRA—between estates that treated Project Notes on their estate tax returns as includible in the gross estate and those that did not—in fact bears a "rational relation to a legitimate governmental purpose."

The distinction in Section 641(b)(2) was designed to eliminate any possible perception of unfairness in the statute's retroactive application. By limiting the retroactive effect of DEFRA to taxpayers who had treated transfers of Project Notes as being subject to estate or gift tax, Congress ensured that DEFRA would not operate retroactively against any taxpayer who might reasonably be thought to have acted in reliance on the assumption that Project Notes were exempt from transfer taxes. At the same time, Congress prevented a rush to the courts by taxpayers who, having previously acted upon the assumption that transfers of Project Notes were indeed subject to tax, sought to secure a windfall based on *Haffner*.[23]

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[23] There can be little doubt that the appellees here were seeking such a windfall. The appellees in *Wells Fargo*, for example, acknowledged in their complaint (¶ 6) that they had believed the Project Notes to be includible in the gross estate when they filed the estate tax return. They stated in their refund claim that it was being filed as a "protective" claim based upon the district court decision in *Haffner* (Complaint Exh. A; see also Complaint ¶ 9). The appellees in

Section 641(b)(2) thus bears a rational relation to the legitimate government purpose of preventing undeserved windfalls at Treasury expense, while not operating retroactively on those who might have relied on what they believed to be a tax exemption under the prior law.[24]

The district court stated (J.S. App. 17a) that "Congress may [not] make * * * a distinction based on a taxpayer's expectations." But since a taxpayer's expectations may be a relevant factor in determining whether a particular retroactive enactment is consistent with due process (see *United States* v. *Hemme*, slip op. 12), such expectations can hardly be deemed an impermissible basis for drawing a distinction for equal protection purposes. As explained by the district court in *Estate of Bradford* v. *United States*, 645 F. Supp. 476, 480 (N.D. Cal. 1986):

> The obvious purpose which the distinction in Section 642(b) furthers is to mitigate the consequences of which plaintiff complains in its due process argument. A rational legislature could conclude that estates which have not included Project Notes on their returns are less likely to have had notice that the notes might be subject to taxation than estates which have included them.

To the extent that due process contemplates consideration of a taxpayer's expectations, it cannot be that a distinction rationally drawn on the basis of a taxpayer's expectations violates equal protection. If the rule were otherwise, Congress would have little, if any, latitude to act without violating one or the other of the Fifth Amendment's proscriptions.

Congress has often found it appropriate to draw distinctions akin to that challenged here, *i.e.*, excluding from the retroactive effect of a clarifying tax provision taxpayers who had already taken action indicating disagreement with the prior interpretation now ultimately adopted by Congress. See, *e.g.*, *Commissioner* v. *Fisher*, 327 U.S. 512, 515 (1946); see also *Dixon* v. *United States*, 381 U.S. 68, 79 (1965) ("rational" to draw line under which revocation of acquiescence is not applied to a category of ratepayers whose reliance on prior acquiescence was "more understandable"). Indeed, this Court itself has drawn a similar distinction in delineating the retroactive effect of Fourth Amendment decisions. Such decisions apply retroactively to cases pending on direct review at the time of the clarifying decision, but cannot necessarily be invoked in a new action commenced later, such as a petition for habeas corpus relief. See *United States* v. *Johnson*, 457 U.S. 537, 562 (1982).

Rosenberg filed their estate tax return on March 30, 1983, but did not file their refund claim until August 15, 1984. The reason given for the refund claim was the intervening district court decision in *Haffner*, issued on April 25, 1984 (Complaint, Exhibit A).

[24] It should be emphasized that all Congress did in drawing the challenged classification in DEFRA was to permit certain estates to continue to *litigate* the question of the taxability of the Project Notes—where they had already determined to take that course without regard to DEFRA by deciding not to treat Project Notes as taxable on the estate tax return. Thus, DEFRA essentially preserved the *status quo ante* in this respect. Those estates that had accepted the well established treatment of Project Notes were held to their decision; those estates that had determined to contest that well established treatment were permitted to go ahead and have their day in court. In short, the classification of which appellees complain is as much a product of self-selection as it is of any affirmative action taken by Congress.

Appellee Wells Fargo criticizes the distinction drawn by Congress here, stating that it "penalizes forthright taxpayers * * * and rewards aggressive * * * taxpayers" (Mem. in Response to J.S. at 17). In attempting to take account of taxpayers' reasonable expectations, however, Congress was not obliged to set up a system in which taxpayers' subjective assertions as to their expectations would be dispositive. Rather, Congress could rationally use the positions staked out in taxpayer's returns as objective evidence of their expectations, reasoning that "estates which have not included Project Notes on their returns are less likely to have had notice that the Notes might be subject to taxation than estates which have included them" (*Estate of Bradford*, 645 F. Supp. at 480). The line thus drawn may not be a perfect one, but it is a rational one, and therefore it satisfies the requirements of the Equal Protection Clause.

CONCLUSION

The judgment of the district court should be reversed.

Respectfully submitted.

CHARLES FRIED
Solicitor General

MICHAEL C. DURNEY
Acting Assistant Attorney General

ALBERT G. LAUBER, JR.
Deputy Solicitor General

ALAN I. HOROWITZ
Assistant to the Solicitor General

MICHAEL L. PAUP
ERNEST J. BROWN
DAVID I. PINCUS
Attorneys

AUGUST 1987

APPENDIX

The Fifth Amendment to the United States Constitution provides in pertinent part:

> No person shall * * * be deprived of life, liberty, or property, without due process of law; * * *

Section 641 of the Deficit Reduction Act of 1984, Pub. L. No. 98-369, 98 Stat. 939 provides:

CLARIFICATION OF TREATMENT OF CERTAIN EXEMPTIONS FOR PURPOSES OF THE FEDERAL ESTATE AND GIFT TAXES:

(a) *General Rule.*—Nothing in any provision of law exempting any property (or interest therein) from taxation shall exempt the transfer of such property (or interest therein) from Federal estate, gift, and generation-skipping transfer taxes. In the case of any provision of law enacted after the date of the enactment of this Act, such provision shall not be treated as exempting the transfer of property from Federal estate, gift, and generation-skipping transfer taxes unless it refers to the appropriate provisions of the Internal Revenue Code of 1954.

(b) *Effective Date.*—

"(1) *In General.*—The provisions of subsection (a) shall apply to the estates of decedents dying, gifts made, and transfers made on or after June 19, 1984.

"(2) *Treatment of certain transfers treated as taxable.*—The provisions of subsection (a) shall also apply in the case of any transfer of property (or interest therein) if at any time there was filed an estate or gift tax return show-

ing such transfer as subject to Federal estate or gift tax.

"(3) *No inference.*—No inference shall arise from paragraphs (1) and (2) that any transfer of property (or interest therein) before June 19, 1984, is exempt from Federal estate and gift taxes.

The United States Housing Act of 1937, ch. 896, 50 Stat. 888 provides:

SEC. 5.

* * * * *

(e) The Authority, including but not limited to its franchise, capital, reserves, surplus, loans, income, assets, and property of any kind, shall be exempt from all taxation now or hereafter imposed by the United States or by any State, County, municipality, or local taxing authority. Obligations, including interest thereon, issued by public housing agencies in connection with low-rent housing or slum-clearance projects, and the income derived by such agencies from such projects, shall be exempt from all taxation now or hereafter imposed by the United States.

SEC. 20. (a) The Authority is authorized to issue obligations, in the form of notes, bonds, or otherwise, which it may sell to obtain funds for the purposes of this Act. The Authority may issue such obligations in an amount not to exceed $100,000,000 on or after the date of enactment of this Act, an additional amount not to exceed $200,000,000 on or after July 1, 1938, and an additional amount not to exceed $200,000,000 on or after July 1, 1939. Such obligations shall be in such forms and denominations, mature within such periods not exceeding sixty years from date of issue, bear such rates of interest not exceeding

4 per centum per annum, be subject to such terms and conditions, and be issued in such manner and sold at such prices as may be prescribed by the Authority, with the approval of the Secretary of the Treasury.

(b) Such obligations shall be exempt, both as to principal and interest, from all taxation (except surtaxes, estate, inheritance, and gift taxes) now or hereafter imposed by the United States or by any State, county, municipality, or local taxing authority.

* * * * *

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APPELLEE'S

BRIEF

Supreme Court, U.S.
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No. 86-1521

In the Supreme Court
OF THE
United States

OCTOBER TERM 1987

UNITED STATES OF AMERICA,
Appellant,

vs.

WELLS FARGO BANK, et al.,
Appellee.

UNITED STATES OF AMERICA,
Appellant,

v.

HARRY ROSENBERG and ARTHUR ROSEN, etc.,
Appellees.

On Appeal from the United States District Court for the Central District of California

BRIEF FOR THE APPELLEES ROSENBERG AND ROSEN Co-Trustees of the Morris Folb Trust

ERWIN N. GRISWOLD
JONES, DAY, REAVIS & POGUE
Metropolitan Square
1450 G Street, N.W.
Washington, D.C. 20005-2088

MARK G. ANCEL
(Counsel of Record)
BAKER & ANCEL
625 Wilshire Blvd.
Seventh Floor
Los Angeles, CA 90017
(213) 624-9201
Counsel for Appellees

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QUESTIONS PRESENTED

1. Whether DEFRA Section 641(b)(2) should be interpreted to preclude Appellees from litigating on the merits the issue of whether certain Project Notes issued under the Housing Act of 1937 are subject to the Federal estate tax.

2. If the question presented in paragraph 1 above is answered in the affirmative, whether DEFRA Section 641(b)(2) violates the Due Process Clause or the Equal Protection component of the Fifth Amendment to the United States Constitution.

3. If the question presented in paragraph 1 above is answered in the negative, whether this Court should remand this case for further proceedings consistent with this Court's decision, without addressing the substantive question presented in paragraph 4 below.

4. If the question presented in paragraph 1 above is answered in the negative and the question presented in paragraph 3 above is answered in the negative, or alternatively if the question presented in paragraph 2 above is answered in the affirmative, whether the court below was correct in following *Haffner v. United States*, 757 F.2d 920 (7th Cir. 1985), in holding that the Project Notes are exempt from all tax, including the Federal estate tax.

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No. 86-1521

In the Supreme Court

OF THE

United States

OCTOBER TERM 1987

UNITED STATES OF AMERICA,
Appellant,

VS.

WELLS FARGO BANK, et al.,
Appellee.

UNITED STATES OF AMERICA,
Appellant,

V.

HARRY ROSENBERG and ARTHUR ROSEN, etc.,
Appellees.

On Appeal from the United States District Court for the Central District of California

BRIEF FOR THE APPELLEES ROSENBERG AND ROSEN Co-Trustees of the Morris Folb Trust

STATEMENT

This is an appeal by the United States from the judgment of the United States District Court for the Central District of California in favor of Appellees, Harry Rosenberg and Arthur Rosen, as Co-Trustees of the Morris Folb Trust. The legal issues presented by

this appeal and by the appeal in *United States of America v. Wells Fargo Bank, et al.*, which has been consolidated with this case, relate to the Federal estate tax treatment of certain short-term obligations of State and local public housing agencies ("Project Notes") issued pursuant to the Housing Act of 1937, Pub.L. 75-4123, 50 Stat. 888 (1937), 42 U.S.C. § 1437 (the "1937 Act").

Appellees were co-executors of the estate of Morris Folb, who died on July 1, 1982, and are co-trustees of a trust to which Folb's net estate was distributed. At the time of his death, Folb owned Project Notes in the aggregate face amount of $500,000, which matured on various dates in 1982 subsequent to his death. On March 30, 1983, Appellees filed a Federal estate tax return for Folb's estate and paid the Federal estate tax of $221,519.80. On Schedule C of that return, Appellees listed the Project Notes, plus accrued interest thereon, describing them as "federally-insured, short-term tax-exempt San Francisco Project Notes," and included the value thereof in the gross estate.

On April 25, 1984, the District Court for the Northern District of Illinois decided *Haffner v. United States*, 585 F.Supp. 354 (N.D.Ill. 1984). On appeal, *Haffner* was affirmed, with the District Court's opinion adopted (with minor modifications) by the Court of Appeals, 757 F.2d 920 (7th Cir. 1985). *Haffner* held that such obligations are exempt from Federal estate taxation pursuant to Section 5(e) of the 1937 Act (now codified as 42 U.S.C. § 1437i(b)), which provides that Project Notes "shall be exempt from all taxation now or hereafter imposed by the United States." Appellant determined, and published its decision, not to seek resolution of *Haffner* through a petition for certiorari.

Following the *Haffner* decision, Congress enacted Section 641 of the Deficit Reduction Act of 1984 ("DEFRA"), Pub.L. 98-369, 98 Stat. 939, which became law on July 18, 1984. One of the questions involved here is the application of Section 641 to this Appeal.

On May 23, 1985, following the failure of the Service to act upon their claim for refund, Appellees filed an action seeking refund of an overpayment of Federal estate taxes in the United

States District Court for the Central District of California, on the ground that the Project Notes held by the Folb estate were not subject to Federal estate tax.

Cross motions for summary judgment were filed by the Appellant and Appellees. The Appellant in its memoranda of law to the District Court set forth *in haec verba* portions of its brief to the Seventh Circuit in *Haffner*. Appellant was aware that to provide for uniform administration of the tax laws, under the strong policy of the Ninth Circuit Court of Appeals, the District Court would ordinarily hesitate to reject the view of the Seventh Circuit. *First Charter Financial Corp. v. United States*, 669 F.2d 1342, 1345 (9th Cir. 1982).

On October 20, 1986, the District Court followed the *Haffner* decision, and held that the Project Notes were exempt from Federal estate taxes under Section 5(e) of the 1937 Act. (J.S.A., at 18A) The court further held that the retroactive application of DEFRA Section 641(a) to Appellees was an unconstitutional violation of the Fifth Amendment (*Id.*, at 14A-17A) on two grounds. First, the court found that "retroactive application of Section 641 is arbitrary and invalid under the Due Process Clause of the Fifth Amendment." (*Id.*) In addition, the court found that "DEFRA Section 641(b)(2) creates a classification scheme that is arbitrary and capricious." (*Id.*) Congress, the court held, may not "retroactively pass a law that discriminates against taxpayers who paid a tax and filed for a refund in favor of those who chose not to pay the tax." (*Id.*) On this basis, Section 641(b)(2) was held to violate the Equal Protection component of the Fifth Amendment.

SUMMARY OF ARGUMENT

1. While this case is before this Court because the court below found DEFRA Section 641(b)(2) unconstitutional, the Court need not reach the constitutional issue. Although it is clear that DEFRA Section 641 as construed by the Government would violate both the Due Process Clause and the Equal Protection

component of the Fifth Amendment, that unconstitutional construction need not be adopted.

DEFRA Section 641(a) provides generally that Project Notes are not exempt from the Federal estate tax. DEFRA Section 641(b)(1) clearly provides that the above rule applies only to decedents dying or transfers made on or after the effective date — June 19, 1984. DEFRA Section 641(b)(2) provides that even if the transfer was made prior to June 19, 1984, Project Notes are not exempt from Federal estate taxes "if at any time" a return was filed treating such Project Notes as taxable. The Government argues that "at any time" includes returns filed before June 19, 1984. Such a reading, however, violates the strong policy against retroactivity and is contrary to established precedent.

In order to impose taxes retroactively, Congress must make its intention to do so explicit. The language contained in Section 641(b)(1) is explicit; the "at any time" language contained in Section 641(b)(2) is far from explicit, particularly when read in light of the entire statute. In closely similar circumstances, this Court has twice held that identical language was not sufficiently specific to provide for retroactive application of a change in estate tax law.

Appellees' construction, on the other hand, is more equitable because it would not preclude taxpayers who had acted properly in accordance with everyday procedure and in conformance with 26 U.S.C. § 7422 from asserting the substantive legal position that the Project Notes are not taxable. Appellees' construction comports better with Sections 641(b)(1), 641(b)(3) and 642 of DEFRA, since it is consistent with the clear desire of Congress, expressed in Section 641(b)(1), that the change in law be given only very limited retroactive effect. It is consistent with the clear intent expressed in DEFRA Sections 641(b)(3) and 642 that the question of taxability of pre-effective date transfers of the Project Notes be allowed to be determined by the courts in due course. Finally, the Appellees' construction makes it unnecessary for this Court to decide constitutional questions. Accordingly, this Court

should hold that DEFRA Section 641(b)(2) applies only to returns filed on or after June 19, 1984.

2. However, if the Court should decide to adopt the Government's reading of DEFRA Section 641(b)(2), it is clear that provision violates the Equal Protection component of the Fifth Amendment. The distinction attempted here — between taxpayers who chose to include or exclude the project Notes on their returns — discriminates between similarly situated individuals and bears no rational relationship to any legitimate governmental purpose. Contrary to the Government's assertion, such a distinction cannot enhance equity or the appearance of equity. Moreover, contrary to the Government's underlying premises, the choice to include the Project Notes on the return and later sue for refund in no way can be held to indicate the decedent's, or even the executors', subjective belief as to whether the Project Notes were taxable. Further, while the subjective belief of decedents or executors might in some way be relevant for due process purposes (the Government argues that such belief might alleviate the problem of lack of notice), it has no place in equal protection analysis. In brief, the choice of one of two equally valid procedural alternatives cannot serve as a reasonable basis for discriminatory treatment. Numerous cases have so held in closely analogous circumstances.

3. Under the Government's reading, DEFRA Section 641(b)(2) violates the Due Process Clause as well. First, the Government's interpretation of DEFRA Section 641(b)(2) would deny Appellees the opportunity ever to have their claim finally adjudicated by a court of law, and thus violates the requirement that an aggrieved taxpayer must, at some stage of the tax collection process, have access to judicial review. Second, the Government's interpretation attempts to impose a new tax on previously untaxed property, in a situation where the taxpayer could have altered his behavior if the change in law had not been retroactive, and in a case where the taxpayer had absolutely no notice that such a provision would be enacted. Thus, the Government's attempt to impose unlimited retroactivity is harsh and oppressive and must fail.

4. If this Court adopts the statutory construction argument of Appellees referred to above at paragraph 1 there will be no need for it to consider either the constitutional issues or the substantive issue of whether the Project Notes were exempt from Federal estate taxation under Section 5(e) of the 1937 Act. This would be in full accord with this Court's principle of declining to rule on issues where such decision would be unnecessary or premature.

Should this Court decline to follow the course suggested above, Appellees submit that Congress clearly intended for the Project Notes to be exempt under the 1937 Act. Both the ordinary rules of statutory construction and explicit legislative history ordain this result. The Government's counter-argument strains credibility by assuming that neither Congress nor the bill's leading spokesman understood what they were doing, and is contrary to the expressly articulated understanding of the persons charged with administering the Act at the time it was passed.

ARGUMENT

I.

UNDER THE MOST APPROPRIATE INTERPRETATION OF DEFRA SECTION 641(b)(2), APPELLEES ARE NOT PRECLUDED FROM LITIGATING THEIR CLAIM ON THE MERITS, AND CONSEQUENTLY APPELLEES WERE ENTITLED TO RAISE THE ISSUE CONCERNING THE PROPER CONSTRUCTION OF SECTION 5(e) OF THE 1937 HOUSING ACT IN THE COURT BELOW.

The Government argues that DEFRA Section 641(b)(2) precludes Appellees from litigating the issue of whether the Project Notes are exempt from the Federal estate tax. As contended in part II of this Argument, below, such an interpretation directly raises the question of the constitutionality of Section 641(b)(2) under the Fifth Amendment.

This Court need not reach the constitutional issues, and need not strike down DEFRA Section 641(b)(2), because, correctly construed, that provision is not applicable to the Appellees' case.

The effective date provisions of DEFRA Section 641 deal with two types of tax events: (1) certain transfer events ("decedents dying, gifts made, and transfers made on or after June 19, 1984"), which DEFRA Section 641(b)(1) addresses (and are not relevant here); and (2) the filing of estate and gift tax returns, which DEFRA Section 641(b)(2) addresses. Section 641(b)(1) unambiguously establishes that the transfer events to which it applies are only those occurring on or after June 19, 1984, thus explicitly providing for a slight period of retroactivity, with regard to the first type of taxable event. Section 641(b)(2) is less clear as to the effective date. It uses the phrase "at any time." The Government argues that this phrase means Section 641(b)(2) applies to any estate tax return, no matter when filed, so long as the Project Notes in question were treated as taxable in an estate tax return. The Government thus would give Section 641(b)(2) *unlimited* retroactive application.

It is well established, however, that retroactivity is generally not favored, and that even in tax cases the courts will give retroactive effect to a statute only if there is a clear and explicit indication that this was intended by Congress.[1]

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[1]Moreover, as discussed in part II of this Argument, below, it is clear that adoption of the Government's construction of DEFRA Section 641(b)(2) raises serious doubts, to say the least, about the constitutionality of the statute. In such cases, this Court has held that it will construe a statute so as to avoid serious constitutional questions. *Ullman v. United States*, 350 U.S. 422, 433 (1956); *Guessefeldt v. McGrath*, 342 U.S. 308, 319-320 (1952); *Crowell v. Benson*, 285 U.S. 22, 62 (1932). Appellees' interpretation would make the constitutional issue moot; the Government's interpretation would necessarily present complex and serious constitutional questions. Under these circumstances, it appears clear that this Court should adopt Appellees' construction of the statute. This is especially true where, as here, the Government's retroactive construction implicates "grave doubts" concerning the constitutionality of the statute. *Llewellyn v. Frick*, 268 U.S. 238, 251-252 (1925). As this Court stated in *Guessefeldt, supra*, with reference to the proper construction of 50 App.U.S.C. § 1 *et seq.* (the "Trading with the Enemy Act"): "Certainly, the constitutional problem is not imaginary, and the claims not frivolous which would have to be rejected to decide in

This Court's holding in *Shwab v. Doyle*, 258 U.S. 529 (1922), seems closely applicable here. That case involved a decedent who had established a trust prior to enactment of Section 202 of the Estate Tax Act of September 8, 1916. The decedent died seven days after passage of the Act. The Act used the same broad language which is used in the statute here. It provided that transfers of property made "at any time" in contemplation of death were includible in the gross estate of decedents dying after passage of the Act. The trust assets would thus have been includible in decedent's gross estate if the statute applied to her transfer. The Government argued that "at any time" included decedent's transfer (which of course it did, literally, as here). This Court rejected that contention, holding the effect of the Act to be prospective only, notwithstanding the "at any time" language. The Court stated that laws must not be construed to be retroactive "unless that intention be clearly declared," quoting Justice Story's comment in *Commentaries on the Constitution of the United States* § 1398 (1833), that "retroactive laws are, indeed, generally unjust; and, as has been forcibly said, neither accord with sound legislation nor with the fundamental principles of the social compact." The Court concluded that Congress must provide "clearness of declaration when burdens are imposed upon completed and remote transactions, or consequences given to them of which there could have been no foresight or contemplation when they were designed and consummated." *Id.* at 534.[2]

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the Government's favor. Considering that confiscation is not easily to be assumed, a construction that avoids it and is not barred by a fair reading of the legislation is invited." *Id.* at 319-320.

[2]In *Shwab* and three companion cases decided at the same time, the Court reversed the decisions of two circuit courts and a district court, all holding Section 202 of the Estate Tax Act to be retroactive on a "plain meaning"-type analysis. *See Union Trust Co. of San Francisco v. Wardell*, 258 U.S. 537 (1922), reversing *Union Trust Co. of San Francisco v. Wardell*, 273 F. 733 (N.D. Cal. 1921); *Levy v. Wardell*, 258 U.S. 542 (1922), reversing an apparently unreported case from the Northern District of California; and *Knox v. McElligott*, 258 U.S. 546 (1922), reversing *McElligott v. Kissan*, 275 F. 545 (2d Cir. 1921). *Shwab* reversed *Shwab v. Doyle*, 269 F. 321 (6th Cir. 1920).

In *Hassett v. Welch*, 303 U.S. 303, 314 (1938), this Court again found the identical phrase ("at any time"), in legislation enacted by Congress to close a perceived estate tax abuse, insufficiently explicit to overcome the strong presumption against legislative retroactivity. That case involved a decedent who had established a trust, but had retained a life interest in the trust. This device was designed to avoid the rule considered in *Shwab, supra*. After transfer of the trust assets to the trust, but before the decedent's death, Congress amended the law to make this technique ineffective. As amended, the statute provided that transfers "at any time" to trusts in which grantor-decedents retained life interests were includible in the decedents' gross estates. This Court rejected the Government's argument that "at any time" should be construed to make the statute applicable to a transfer which had been made prior to enactment of the amendment, citing the strong presumption against retroactivity. *Id.* at 314.

The compelling reasons for the presumption against retroactivity are especially apt as regards the estate tax returns falling within DEFRA Section 641(b)(2). As noted by the court in *Netsky v. United States*, 652 F.Supp. 783, 785 (E.D.Pa. 1986), estate executors are fiduciaries and have a duty to adopt conservative tax positions to conserve the assets of estates. Under current Federal tax procedures, taxpayers may contest a tax either by failing to show the tax as due on their return, and thus refusing to pay it, or by paying the tax and subsequently claiming a refund. Because under the former procedure the taxpayer may be liable for interest and penalties if he does not prevail in his challenge, often the prudent option is to pay, even if one believes that the tax is not due, and then to seek a refund.[3] Penalizing fiduciaries for adopting the conservative, prudent position is the sort of "unjust" act and "unforeseeable burden" which the presumption against retroactivity seeks to prevent.

As this Court pointed out in *Shwab*, it is not unreasonable to demand explicit language from Congress if it intends to impose

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[3]See pages 16-18, *infra*.

such a burden. Congress certainly knows how to make explicit its intent that certain laws have retroactive effect. It did so in other provisions of the legislation considered in *Shwab*, just as it did in other provisions of the legislation presently at issue. "If Congress . . . had the purpose assigned to it by the Commissioner it should have declared it; when it had that purpose it did declare it." *Shwab, supra*, 258 U.S. at 536.

Nor can the Government point to any authoritative legislative history which would serve to overturn the presumption against retroactivity. Indeed, the legislative history of DEFRA Section 641 is virtually nonexistent. The Government purports to rely on a document prepared by the Staff of the Joint Committee on Taxation, 98th Cong., 2d Sess., *General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984*, at 972 (Joint Comm. Print 1984) (the "Blue Book"). The Blue Book does indeed comment on retroactivity. Although such comments may sometimes be regarded as useful in determining legislative intent, they are not "legislative history," having been prepared after the fact, and by staff, rather than by members of Congress. They were, indeed, never seen by *any* member of Congress prior to passage of the statute. Thus, the Blue Book "does not directly represent the views of the legislators or an explanation available to them when acting on the bill." *McDonald v. Commissioner*, 764 F.2d 322, 336-337, n. 25 (5th Cir. 1985); *see also Estate of Hutchinson v. Commissioner*, 765 F.2d 665, 669-670 (7th Cir. 1985). Indeed, the Government's own regulations provide that comments contained in the Blue Book do not constitute "substantial authority" (in fact, they state that General Explanations prepared by the Joint Committee Staff "are not authority") for purposes of the substantial understatement penalty of 26 U.S.C. § 6661. In contrast, "committee reports, joint explanatory statements of managers included in conference committee reports, and floor statements made prior to enactment by one of a bill's managers" will be considered authority. Treas. Reg. § 1.6661-3(b)(2). Accordingly, especially where there is no other legislative history to give direct supporting evidence of legislative intent, the staff comments should in no way be considered

authoritative or "unequivocal evidence of legislative intent." *Zinniel v. Commissioner*, 89 T.C. No. 32 (August 26, 1987).[4]

Given the absence of an explicit statement or unequivocal evidence of contrary intent by Congress, the more rational interpretation in this case, as in *Hassett*, is that while Congress was concerned about refund claims, it nevertheless intended to stay within the limits it had imposed on the retroactive effect of the provision in DEFRA Section 641(b)(1). Thus, with regard to transfer events, it imposed a limitation of effective date to those transfers occurring on or after June 19, 1984. In DEFRA Section 641(b)(2), it extended that effect to transfers which occurred *before* the effective date of the Act, but only if the corresponding tax return was filed on or after the Act's effective date.

This interpretation avoids the harsh and inequitable consequences which flow from the Government's reading of the statute, since those persons affected by the new provisions would have

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[4]Moreover, the staff comments in the Blue Book, even if they might otherwise be useful, contain conflicting statements about the purported intended retroactive effect of DEFRA Section 641. The Blue Book first states generally that "although . . . Congress was extremely concerned about the *Haffner* opinion, it determined that the statutory provisions should apply only to transfers occurring after June 18, 1984, rather than to past transfers." Later, however, it states that "[t]he provisions also apply to transfers occurring before June 19, 1984, if the transfers previously were reported as subject to Federal transfer tax. No claims for refunds may be filed, therefore, with respect to such transfers."

Similarly conflicting statements, though made by a more authoritative source, were present in *Hassett, supra*, 303 U.S. 303 (1938). In explaining the legislation on the floor, where the amendment was proposed and adopted without having been previously reported, Congressman Hawley, who was the manager for the bill on the floor, also evidenced a similar concern about refund claims, but only after he had made broad general statements to the effect that the loophole was intended to be unavailable for *future* transactions. This Court failed to credit the statements supporting retroactivity and instead, as discussed above, held that despite the use of the phrase "at any time" in the statute, the law should be applied in a prospective manner. *Hassett, supra*, at 310-311.

notice of the new requirements and be able to act accordingly — *e.g.*, claiming exemption in their returns if they felt that claim were justified, in order to preserve their rights to litigate the claim and, as with Appellees, to fulfill their fiduciary duties. Thus, contrary to the Government's assertion, Appellees' reading of DEFRA Section 641(b)(2), far from making that provision "a dead letter," is the most equitable way of reading the statute, and complies with prior decisions of this Court.[5]

Consistent with evident congressional concerns, Appellees' construction would make the statute applicable to filers *with notice of the new law*, and thus reduce the incidence of refund claims, while avoiding application to those who had absolutely no notice that their entirely proper actions would later penalize them by foreclosing their right to contest the tax in question.

Finally, Appellees' construction is wholly consistent with the intent obvious in DEFRA Sections 641(b)(1), 641(b)(3) and 642 to encourage and to facilitate the process of judicial determination of the taxability of pre-effective date transactions. Under the system established by the interaction of Sections 641(b)(1), 641(b)(3) and 642, estates of decedents dying after June 18, 1984 are subject to the new law. Estates of decedents dying before June 19, 1984 but after December 31, 1983 — whose tax returns, therefore, would generally be filed after the June 19, 1984 effective date — must *report* the transfer of Project Notes but are entitled to judicial determination of their taxability under the old law, which judicial determination is to be unaffected by the new law. Besides giving notice to pre-effective date decedents' executors who file estate tax returns after the effective date that they must assert their claim to exemption under the old law if they wish to preserve it, this system aids the Government in identifying those cases where the issue of taxability exists as well as in determining the amount of tax due if a tax is judicially determined to be due under the old law. Such a system of

[5] *See also, United States v. Darusmont*, 449 U.S. 292, 296-297 (1981) (*per curiam*), noting that retroactive application of tax statutes "has been confined to short and limited periods . . . ."

encouraging reporting and penalizing non-reporting, with its obvious benefits both to the Government and those filing returns, is incompatible with the Government's interpretation of DEFRA Section 641(b)(2), which would have Congress rewarding non-reporting and nonpayment, and penalizing reporting and payment, by executors who filed returns without notice of the new law. In addition, if the Government's interpretation were adopted, cases already well along in the judicial process, even up to the level of appellate courts, could suddenly be aborted — not on the merits previously argued, but simply because the taxpayers had chosen to include the Project Notes in the tax returns and claim a refund rather than to go to the Tax Court.[6]

In summary, Congress failed to make its alleged broadly retroactive intent clear in the statute itself. There is only very general language in the statute and no trace of real legislative history showing a clear intent to apply DEFRA Section 641(b)(2) in the broad manner urged by the Government. Under similar circumstances this Court has refused to accept a retroactive interpretation of a transfer tax statute.

II.

THE RETROACTIVE APPLICATION OF DEFRA SECTION 641(b)(2) WOULD VIOLATE THE FIFTH AMENDMENT OF THE UNITED STATES CONSTITUTION.

If this Court accepts the position urged above, consideration of the constitutional issues arising under the Fifth Amendment will be unnecessary. However, if the Court should reach those issues, we submit that the court below was correct in holding that DEFRA Section 641(b)(2), as interpreted by the Government,

[6] Indeed, the Government's interpretation would place a greater procedural burden on taxpayers than the common law requirement of payment of taxes under protest, which was abolished more than sixty years ago pursuant to Section 1014 of the Revenue Act of 1924, P.L. 68-176, 68th Cong. 1st Sess., 43 Stat. 343.

violates both the Due Process Clause and the Equal Protection component of the Fifth Amendment.

A. The Retroactive Application of DEFRA Section 641(b)(2) Would Violate the Equal Protection Component of the Fifth Amendment.

The Equal Protection component of the Fifth Amendent's Due Process Clause mandates that a tax classification be rationally related to a legitimate governmental purpose. *Regan v. Taxation with Representation*, 461 U.S. 540 (1983). While this standard, often termed the "rational basis" test, does not require the same strict test as that required when a suspect classification or fundamental right is present, judicial scrutiny is nonetheless required. *See, e.g., Williams v. Vermont*, 472 U.S. 14 (1985), and *Hooper v. Bernalillo County*, 472 U.S. 612 (1985) (state use or property tax classification based upon residency); *Cleburne v. Cleburne Living Center*, 473, U.S. 432 (1985) (zoning ordinance requiring special use permit for group home); *Ridgewell's, Inc. v. United States*, 655 F.2d 1098 (Ct.Cl. 1981).

In brief, the equal protection element of due process prohibits Congress from enacting legislation which arbitrarily discriminates between individuals who are similarly situated. To withstand a challenge on equal protection grounds, the distinction drawn by Congress must bear a rational relationship to a legitimate governmental purpose. Although the Government has suggested several legitimate governmental purposes which might be fostered by the change in law contained in DEFRA Section 641(a), it has been unable to suggest any rational relationship between such governmental purposes and the discriminatory application of Section 641(b) as construed by the Government.

As interpreted by the Government, Section 641(b)(2) applies the provisions of Section 641(a) (imposing an estate tax on Project Notes which at least arguably were previously exempt from such taxation by Section 5(e) of the 1937 Act) retroactively to estates of decedent dying before June 19, 1984, so long as the executor for the estate included Project Notes in the gross estate on the estate tax return, regardless of when that return was filed.

But it does not apply the tax to estates where the executor either failed to file a return or, if a return was filed, did not include Project Notes on the return. The Government argues that this distinction serves to prevent undeserved refunds being made to taxpayers who initially reported the Project Notes on their return because such taxpayers could not have relied on any subjective expectation that the Project Notes were not subject to estate tax. On this basis, the Government claims that the distinction operates "to eliminate any possible perception of unfairness in the statute's retroactive application." (Brief for Appellant, 36)

In other words, the Government argues that it is rational to apply one set of laws to one taxpayer and a different set of laws to another taxpayer, even though both own exactly the same property, based not upon any action by either taxpayer but solely upon actions subsequently taken by their fiduciaries; and the justification for such discrimination is that it eliminates any possible perception of unfairness. If indeed this is the purpose behind the distinction, it is necessary merely to state the proposition to demonstrate that it has failed miserably.

The Government seeks to justify its questionable rationale by arguing that the distinction between the two similarly situated taxpayers serves to prevent a "rush to the courthouse"[7] by taxpayers who acted on the assumption that the Project Notes were taxable, while preserving the right to litigate of those taxpayers "who might reasonably be thought to have been acting in reliance on the assumption that Project Notes were exempt

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[7]In an attempt to support its reading of DEFRA Section 641(b)(2), the Government argues that Section 641(b)(2) "bears a rational relation to the legitimate government purpose of preventing undeserved windfalls at Treasury expense . . . ." (Brief for Appellant, 37) This begs the question, for whether there is an "undeserved windfall" turns entirely on the proper construction of the underlying exemption provision contained in the 1937 Act. If the Project Notes *were not* subject to the Federal estate tax, then there could be no "windfall," but rather a vindication of taxpayers' rights. If, on the other hand, the Project Notes were subject to the estate tax, there will be no gain by the litigating taxpayers and thus no windfall.

from transfer taxes." (Brief for Appellant, 37) This premise would be, at best, debatable under any circumstances; it is totally untenable under the current Federal tax procedural structure. In brief, the Government's position ignores the realities of the statutory tax collection and refund procedures.

Under the Federal tax system, two alternative procedural avenues are available to the taxpayer to resolve issues regarding the ultimate taxability of a particular item. The taxpayer's rights are protected regardless of whether or not that taxpayer includes a given item on his return. If the taxpayer or his representative fails to report an item which the Internal Revenue Service believes to be ultimately taxable, the Service may conduct an audit and, in accordance with applicable procedures and regulations, can initiate proceedings to assess and collect the resulting deficiency. *See* 26 U.S.C. §§ 6102 *et seq.*, and 6651 *et seq.*

The taxpayer or his representative may, alternatively, choose to include the disputed item as taxable on the return, pay the tax due, and file a claim for refund. *See* 26 U.S.C. §§ 6401, *et seq.* and 7422. This procedure has the advantage of avoiding the risk of liability for interest and penalties, without losing the opportunity to litigate the issue in the United States Claims Court or Federal District Court. In adopting this alternative, a taxpayer has not, for more than fifty years, been required to pay the tax under protest, or to take any other action to notify the Government that he disputes the tax treatment of a particular item as a precondition to filing a refund claim and eventually obtaining an administrative or judicial decision on the merits of this position. *See* 26 U.S.C. § 7422(b).

The tax liability of an estate cannot rationally be affected by looking to the filing position chosen by the executor. Such an attempted distinction is not merely "imperfect" (Brief for Appellant, 39); it is completely unjustifiable, because in light of the procedural alternatives discussed above, no inference regarding the fiduciary's expectations of taxability logically can be drawn. The Government's position is tantamount to the taxpayer stating that, because the Government did not deny the Appellees' claim

for refund and because the Government has settled a substantial number of *Haffner* claims and failed to petition for certiorari in the *Haffner* case, the Government has admitted that the *Haffner* case was correctly decided.[8]

If the Government's position were to prevail, the possibility of retroactive application of future tax laws could force future taxpayers, acting strictly in self-defense, to take an aggressive position with respect to any item about which there could be any potential tax issue. Thus, the Government's position not only unfairly discriminates against taxpayers who have chosen one of two equally proper filing procedures; it also encourages aggressive non-reporting or outright noncompliance, thereby undercutting our tax collection system, which is heavily dependent upon voluntary reporting and compliance.

Moreover, the Government argues that the *decedents* in this case are more likely to have had notice of the taxability of Project

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[8] In its Brief, the Government asserts that "Congress has often found it appropriate to draw distinctions akin to that challenged here . . . ." (Brief for Appellant, 38) In support of this assertion, the Government cites *Commissioner v. Fisher*, 327 U.S. 512 (1946), and *Dixon v. United States*, 381 U.S. 68 (1965). Neither of these authorities is apposite to the issue here, which is whether basing the retroactivity of a new law on the manner in which a taxpayer filed its tax return is unfairly discriminatory. Additionally, the Government urges that this Court's refusal to apply Fourth Amendment decisions retroactively with regard to *habeas corpus* actions brought after the date of a Fourth Amendment decision somehow supports the constitutionality of the distinction allegedly drawn in DEFRA Section 641(b). Even apart from the obvious fact that the operation of the criminal justice system is quite different from that of the civil tax system, a refund suit is not a collateral attack on a previously decided case as is a *habeas corpus* action, but instead, is an initial case on the merits. In the former case, the litigant had the opportunity to raise the issue and have it adjudicated by a court of law, but failed to do so. In this case, the taxpayer's legal representatives availed themselves of one of two equally valid methods of challenging the tax in question, only to have their right to obtain judicial review on the merits of their claim abolished after they had made what was at the time an entirely proper choice of procedure.

Notes than decedents holding Project Notes at their death whose executors decided not to report the Notes on their estate tax returns, and that the presence or absence of such notice provides a rational justification for the distinction in question. Even if it could be inferred that the procedure chosen by the fiduciaries in some way showed a subjective belief or expectation on their part that the Project Notes would be taxable, any such belief would be totally irrelevant to the issue of the decedent's "notice." The estate tax is a tax imposed on the transfer of the taxable estate of a decedent. 26 U.S.C. § 2001(a). The taxable estate of a decedent is determined, in part, by valuing all property held by the decedent *at the time of death*. 26 U.S.C. §§ 2051, 2031(a). Thus, since the estate tax is a transfer tax imposed on taxable property owned at the decedent's death, the only expectation which could possibly be germane — assuming *arguendo* that any subjective expectation could determine taxability — would be that of the decedent prior to his death, not the expectation of the executor at the time the return was filed nine months later. Any expectation of taxability which might be imputed to a taxpayer based upon the executor's inclusion of Project Notes in the estate tax return is therefore without rational foundation, and, moreover, is simply irrelevant.[9]

While the Government is unable to cite any relevant authority in support of the constitutionality of DEFRA Section 641(b)(2), Federal courts on four separate occasions have made clear that the type of distinction drawn by Section 641(b) is improperly discriminatory.

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[9]Appellees do not concede that such lack of reliance, even if it could be demonstrated by their filing position, would protect the Government's proffered interpretation from attack under an equal protection analysis. While the question of taxpayer notice has a bearing on whether retroactive application of a tax can withstand challenge on due process grounds, such considerations have never been applied for equal protection purposes. The attempted rationale of the classification, however, is so inadequate and irrational on its own terms that this point need not be considered in any great detail.

Connecticut Railway and Lighting Company v. United States, 135 Ct.Cl. 650, 142 F.Supp. 907 (1956), involved a refund suit to recover overpaid income and excess profit taxes. During the years in question, the taxpayer mistakenly included as income certain amounts which at the time were not treated as income by the Service. 135 Ct.Cl. at 652, 653, 142 F.Supp. at 908. Subsequently, the Commissioner of Internal Revenue issued a ruling (Mim. 6779, 1952-1 C.B. 8) providing that in the future, such amounts would be subject to tax. Six months later, in Mim. 51, 1952-2 C.B. 65, the Commissioner amended the previous ruling to make it retroactive, but only as to those taxpayers who had previously included those amounts on their return as income. 135 Ct.Cl. at 653, 142 F.Supp. at 909. When the taxpayer realized that it had erroneously included such amounts in its income, it brought a refund suit. The taxpayer complained that application of the ruling retroactively to only those taxpayers who previously included the reimbursed taxes on their return "discriminates without justification between taxpayers who had paid their taxes and those who had not." 135 Ct.Cl. at 654, 142 F.Supp. at 909. Because the Government in litigation abandoned its reliance on the 1952 retroactivity ruling, the court did not directly hold that the distinction was in violation of the taxpayers right to Equal Protection, but it made it clear that such a distinction, if relied upon, would be discriminatory. It agreed with taxpayer that such a discriminatory distinction could not be upheld. *Id.*

In *Exchange Parts Company of Fort Worth v. United States*, 150 Ct.Cl. 538, 279 F.2d 251 (1960), the Court of Claims relied on *Connecticut Railway* in holding invalid a similar selectively retroactive provision. In determining that the Commissioner could not make a ruling retroactive only with respect to those taxpayers who had previously included on their returns certain revenue as subject to manufacturing excise taxes, the Court of Claims stated:

> the Commissioner had the authority to make this new ruling retroactive, or nonretroactive, as seemed to him wise.

> The Commissioner, however, made his ruling nonretroactive as to certain taxpayers and retroactive as to others, including the plaintiff. And the distinction was based solely upon whether the particular taxpayer had, or had not paid his taxes. We dealt with such an asserted basis for differentiating between taxpayers in *Connecticut Railway & Lighting Co. v. United States*, 142 F.Supp. 907, 135 Ct.Cl. 650, 653-654, and held that the promptly paying taxpayer could not be validly made the object of prejudicial discrimination.
>
> We reach the same conclusion in this case.

150 Ct.Cl. at 543, 279 F.2d at 254.

In *Farmers' and Merchants' Bank v. United States*, 476 F.2d 406 (4th Cir. 1973), the Fourth Circuit Court of Appeals rejected retroactive application turning upon whether a taxpayer had previously included a deduction in its initial return. In that case, the taxpayer bank sought a refund based upon the erroneous exclusion by it from its original return of certain outstanding loans known as "federal funds sold," in computing its 1964 bad debt reserve. *Id.* at 407. In 1966, realizing that the loans should have been included in computing the deductions on its return, the bank filed a claim for refund. While the claim was pending, the Commissioner of Internal Revenue issued Revenue Ruling 68-630, 1968-2 C.B. 84, which stated that federal funds sold would no longer be includable in the bad debt reserve computation. The Commissioner also determined that the ruling was to apply retroactively except as to those taxpayers who had deducted the loans on their original returns. *Id.* at 409.

In rejecting the retroactivity clause of the ruling as unfairly discriminatory, the Fourth Circuit stated:

> The Commissioner cannot tax one and not tax another without some rational basis for the difference.

> . . . either the Government or the taxpayer may rectify an earlier erroneous return. This again demonstrates that the taxpayer's claim was rejected because it was made in the form of a refund request instead of in an original deduction.

Id. at 409-410.

See also Ridgewell's, Inc. v. United States, 655 F.2d 1098 (Ct.Cl. 1981). In that case, an employer sued for a refund of employment taxes he had paid, claiming that the individuals on whose account he had been assessed taxes by the Internal Revenue Service were not employees but independent contractors. Congress had passed an interim relief statute to deal with the growing number of controversies between the Service and employers as to proper employment classification, while it considered the classification issue. The statute provided that employers could not be held liable for taxes for individuals they had not "treated as" employees for the tax years in question. The Government contended that, under Rev. Proc. 78-35, 1978-2, C.B. 536, "treating" an individual as an employee included reporting and paying tax for that individual. The court disagreed:

> First, and most obvious, any interpretation of the statute which makes relief depend on whether the taxpayer sued in the Tax Court, as opposed to district court or the Court of Claims, would be without rational basis and hence unacceptable.

Id. at 1102.

Thus, on at least four occasions, Federal courts have rejected as unfairly discriminatory retroactive application of a revenue ruling or statute against those taxpayers who had previously reported certain tax items on their returns in accordance with the provisions of the new ruling or statute, but not against other taxpayers who had not taken such a reporting position. Clearly, such retroactive application cannot turn on a taxpayer's treatment of an item on his return, without being unfairly discriminatory and therefore in violation of the Equal Protection requirement of the Fifth Amendment. See *Ridgewell's, supra.*

B. The Retroactive Application of DEFRA Section 641(b)(2) Would Violate the Due Process Clause of the Fifth Amendment.

Section 641(a) of DEFRA imposes an estate tax on property which Congress recognized was not necessarily taxable at the date of the decedent's death.[10] To the extent that the Project Notes were taxable prior to its enactment, Section 641 has no substantive effect; to the extent that they were not, Section 641 in effect retroactively imposes a tax on the Notes. The retroactive application of Section 641 to Appellees violates their Fifth Amendment right to due process for two reasons. First, Section 641(b)(2), as construed by the Government, would deny Appellees the opportunity to obtain judicial review of a claim which Congress has recognized is at least colorable, and in this manner violates the requirements of due process. Second, under the circumstances, retroactive imposition of the estate tax is "harsh and oppressive" and therefore does not fall within the bounds which this Court has set for retroactive application of Federal tax statutes.

1. Denial of Judicial Review

The Government has interpreted DEFRA Section 641(b)(2) so as to preclude the right of Appellees to seek review by the Courts of their claim for refund, regardless of the substantive merits of that claim. If this is in fact the proper interpretation of Section 641(b)(2), it is clear that it violates Appellees' right to due process.

Congress has explicitly refused to decide whether *Haffner* was correctly decided, leaving that determination to be made by the courts in due course. But Congress has also provided (if the Government's position is accepted) that Appellees are to be denied their right to a decision on the merits by the courts

[10]See discussion above at pg. 12. Congress clearly intended for the courts to decide the scope of the 1937 Act's tax exemption for those cases which did not fall within DEFRA Section 641's effective date provisions.

because they filed an estate tax return showing the taxes as due. By virtue of this wholly innocent and appropriate act, Appellees are said to be precluded from litigating what Congress has implicitly conceded to be a colorable claim on the merits. Under this interpretation, DEFRA Section 641(b)(2) "applies to rights accrued theretofore and still subsisting" (*United States v. Jefferson Electric Co.*, 291 U.S. 386, 401 (1934)), but bars Appellees from all opportunity to be heard and to obtain a remedy if the tax paid was *not* properly collectible under the applicable law. This is in clear violation of the right to procedural due process, which applies to taxation as well as to any other Federal action. *See, e.g., IT&T Corp. v. Alexander,* 396 F.Supp. 1150, 1164 (D.Del. 1975):

> As a general rule, the citizen *qua* taxpayer possesses a constitutionally cognizable property interest which is implicated by the assessment and collection of taxes. It is accordingly settled that such a citizen must be afforded an opportunity to be heard when the revenue authority proceeds to assess and collect taxes from him.

This Court has recognized the vital importance of collection of taxes (*Bull v. United States,* 295 U.S. 247, 259 (1935)) and thus has held that, even where imposing delay or financial hardship on taxpayers, the "pay and sue" refund procedure is constitutional. *Phillips v. Commissioner,* 283 U.S. 589 (1931). But the fundamental basis for these decisions is that the taxpayer is entitled at some point to "a full, albeit delayed, opportunity to litigate . . . ." *Bob Jones University v. Simon,* 416 U.S. 725, 746 (1974). It is clear that where an aggrieved party has no access at all to judicial review, due process is denied. *Id.; Accord, Commissioner v. "Americans United," Inc.,* 416 U.S. 752, 762 (1974). Here, the taxpayer will never have the opportunity to have the claim "finally adjudicated by a court of law, "*Americans United*", *supra,* at 762, and accordingly, under a long line of cases, the Government's reading of DEFRA Section 641(b)(2) cannot pass constitutional muster.[11]

[11]*See, e.g., Brinkerhoff-Faris Co. v. Hill,* 281 U.S. 673, 679, 681 (1930) (State's foreclosure of means of challenging state tax violated tax-

The taxpayers targeted by DEFRA Section 641(b)(2) (under the Government's interpretation) had but one possible avenue for the determination of their rights as of the effective date of the new law: an action for refund. The alternative method of obtaining a hearing, through the Tax Court, was precluded by Appellees' entirely proper action of including the Project Notes on the tax return, which action was taken long before enactment of Section 641(b)(2). In a similar situation involving a state tax, this Court found in *Brinkerhoff-Faris Co. v. Hill,* 281 U.S. 673, 674, 681 (1930) that the foreclosure of the only remaining avenue of seeking redress violated the taxpayer's Fourteenth Amendment right to due process. *See also IT&T Corp. v. Alexander,* 396 F.Supp. 1150, 1165 (D.Del. 1975) (due process analysis focuses on "objectively justified reliance by the citizen on a particular government benefit" or "existing rules or understandings").

Thus, a taxpayer cannot be denied the right to be heard where his own actions in justified reliance on the law existing at the time of those actions resulted in the loss of an alternate method of

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payer's Fourteenth Amendment right to due process); *Phillips, supra,* 283 U.S. at 595 (summary tax proceedings did not violate Fifth Amendment right to due process because "adequate opportunity is afforded for a later judicial determination of the legal rights" of taxpayer); *United States v. Jefferson Electric Co., supra,* at 402-403 (1934) (statute imposing procedural requirements for specific type of refund action, imposed after tax paid but before claim filed, did not violate due process because merely a restriction on remedy ensuring that those who actually paid the tax received the refund); *Anniston Manufacturing Co. v. Davis,* 301 U.S. 337, 349-350 (1937) (statute imposing procedural rules for claims for refund of taxes paid under tax statute which had been found unconstitutional by Supreme Court did not violate due process where "legal rights are still suitably protected. The immediate question is whether the prescribed procedure gives an opportunity for a full and fair hearing. . . ."); *Bob Jones University, supra* (in refusing to carve out exception to 26 U.S.C. § 7421, the anti-injunction statute, in response to plaintiff's claim that if no exception were made it would be deprived of due process, the Court stated: "This is not a case in which an aggrieved party had no access at all to judicial review. Were that true, our conclusion might well be different.")

obtaining a hearing. Moreover, he cannot be denied the right to be heard where the merits of his claim have not yet been established. The essence of the right to due process is not merely the right to a remedy when a wrong has occurred but the right to try to prove that such wrong occurred. Thus, in *Brinkerhoff, supra,* this Court specifically set to one side the question whether or not the plaintiff's claim for refund of the taxes was valid, stating "[w]e are not now concerned with the rights of the plaintiff on the merits . . . . Our present concern is solely with the question whether the plaintiff has been accorded due process in the primary sense — whether it has had an opportunity to present its case and be heard in its support." *Id.* at 681. In *Phillips v. Commissioner, supra,* at 593, the Court addressed the plaintiff's due process challenge to a summary collection procedure statute even though it was clear that the taxpayer would ultimately be liable for the tax at issue.

Similarly, the basis for the taxpayer's claim need not itself rise to the level of a violation of constitutional rights in order for the right to judicial consideration of that claim to be constitutionally protected. Thus, although *Brinkerhoff* and *Anniston, supra,* both involved constitutional challenges to the tax assessed or paid, *Jefferson Electric, supra,* involved a claim that the excise tax assessed was incorrect because the Government had misclassified some equipment as "automobile parts or accessories".

Thus, regardless of the substantive merits of Appellees' claim under the 1937 Act, the application of DEFRA Section 641(b)(2) to preclude any judicial consideration of the merits of that claim would clearly be in violation of their right to due process — *i.e.,* their right to have the claim fully and fairly adjudicated on the merits by a court of law.

2. Retroactive Imposition of Tax

In *Welch v. Henry,* 303 U.S. 134, 147 (1938), this Court described the standard to be used in determining whether the retroactive imposition of an income tax violated the Due Process Clause:

> In each case it is necessary to consider the nature of the tax and the circumstances in which it is laid before it can be said that its retroactive application is so harsh and oppressive as to transgress the constitutional limitation.

United States v. Darusmont, 449 U.S. 292 (1981) (*per curiam*), recently considered this standard. This Court first noted that, while Federal tax statutes are frequently retroactive in effect, such retroactivity is customarily confined to "short and limited periods" (*Id.* at 297) — in sharp contrast to the Government's position in this case, which would apply DEFRA Section 641(b)(2) to any return regardless of when filed. The opinion then analyzed the application of the minimum tax to a transaction which became taxable by virtue of an amendment which reduced the allowable exemption and increased the minimum tax rate. The transaction was completed before the amendment was enacted and would not have been taxed under old law. This court held that the limited retroactivity involved (less than one year) was permissible because the taxpayer had notice that a change in law was likely, and because the tax resulted from a change in rates in an existing tax, and not from the imposition of a new tax. *Id.* at 299-300.

Application of the *Darusmont* analysis should result in the retroactive effect of DEFRA Section 641(b)(2) being held invalid under the Fifth Amendment. In the first place, this Court noted that where, as here, the tax to be imposed is a retroactive gift or estate tax, the standard is higher than when the tax is an income tax. *Id.* at 229; *see also Welch v. Henry*, 303 U.S. at 147-148; *Untermeyer v. Anderson*, 276 U.S. 440 (1928); *Blodgett v. Holden*, 275 U.S. 142, 147 (1927); *Nichols v. Coolidge*, 274 U.S. 531 (1927).[12]

[12]The Government has suggested that *Untermeyer* is no longer good law, or that, at the very least, the holding in that case should be confined to its facts. As authority for this proposition, it cites *Milliken v. United States*, 283 U.S. 13 (1931); *Darusmont, supra; United States v. Hemme*, 476 U.S. 588 (1986), and a number of lower court decisions. All of these

Where, as here, the tax in question is a transfer tax, the courts will take into account whether the taxpayer could have altered his behavior to avoid the tax had it been anticipated by him at the time the transaction was effected. *Blodgett, supra; Untermeyer, supra.*[13] In this case, of course, the decedent could have modified his behavior had he known of the DEFRA statutes. However, those statutes were not enacted until two years after his death. As the district court noted under very similar circumstances in *Netsky v. United States*, 652 F.Supp. 783, 786 (E.D.Pa. 1986), "at the time he purchased the project notes the decedent could have

cases are easily distinguishable from both *Untermeyer* and the case at bar. None of them considered an *unlimited* retroactivity, as here. Rather, as this Court noted in *Darusmont*, valid retroactive tax statutes have always involved "short and limited periods." *Id.* at 297; *Welch v. Henry, supra*, at 148-151. Further, these cases dealt with adjustments in rates (*e.g., Milliken*), statutory floors (*e.g., Darusmont*), or similar subjects, not the application of tax to a totally new transaction or type of property. *Hemme*, for example, involved the unification of the estate and gift taxes with a "phase in" period which had a retroactive effect primarily through its interaction with the statute taxing gifts made in contemplation of death. The Court relied heavily on the fact that the taxpayer estate was *better off* under the new, unified system — even with the phase-in feature complained of — than it would have been under the previous law. *Hemme, supra*, 569-70. In this case, of course, Appellees will be substantially worse off if the new law is retroactively applied than if it is not. Thus, the cases cited by the Government can have little specific relevance to the case at hand. (*See also* n. 15, *infra*, and accompanying text). In contrast, even if *Untermeyer* were to be read narrowly, the facts of this case are more favorable to the taxpayer than those presented in *Untermeyer*.

[13]As explained in *Shanahan v. United States*, 447 F.2d 1082, 1083 (10th Cir. 1971), "... the justification for upholding retroactive income taxation does not apply to estate and gift taxes because it cannot be assumed that the Taxpayer would dispose of his property in the same manner if he had known about the consequences in relation to the tax." Conversely, the court continued, income taxes imposed retroactively to the beginning of the calendar year or to the date the legislation was introduced are regularly upheld because of the administrative efficiencies realized thereby as well as the legitimate desire "to include profits from transactions consummated while the statute was being enacted."

altered his behavior and engaged in alternative estate planning to reduce his tax liability had he anticipated estate taxes would be levied upon them. For example, he could have made gift transfers, or he could have chosen investments with higher yields."

Second, in contrast to *Darusmont*, the Government has conceded that the decedent did not have notice of the tax at the time he entered into the transaction (Brief for Appellant, 34); the tax was not even proposed until years after the decedent had died. The decedent purchased Project Notes which the Government had represented as tax-exempt, and at least until the Internal Revenue Service issued Revenue Ruling 81-63, 1981-1 C.B. 455, no one had ever suggested otherwise. To avoid this conclusion, the Government suggested that Revenue ruling 81-63 provided adequate notice that a new tax would be imposed on the previously exempt notes. But assuming the validity of *Haffner's* analysis, Revenue Ruling 81-63 was incorrect, and it is illogical bootstrapping for the Government to suggest that an incorrect revenue ruling could possibly serve as notice that Congress might act to change the Federal estate tax law.[14] Indeed, if Revenue Ruling 81-63 were correct, there would be no need to change the law.

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[14]Revenue rulings are merely opinions of the Internal Revenue Service's legal counsel which may be retroactively revoked at any time. They are not regulations and do not bind the Service, but rather, serve to state the legal opinion of the Service at a given time — and thus Rev. Rul. 81-63 merely constitutes the legal opinion of a party of this dispute. Taxpayers rely upon such rulings at their peril. *See Biddle v. Commissioner*, 302 U.S. 573, 582 (1938); *Temple University v. United States*, 769 F.2d 126, 137 (3d Cir. 1985). Accordingly, Rev. Rul. 81-63 cannot reasonably be considered to have given taxpayers any notice that a change in the law might subsequently be enacted by Congress. Furthermore, since the Government's interpretation of DEFRA Section 641 would result in taxing Project Notes in the estates of decedents who died prior to the publication of Rev. Rul. 81-63, as well as those dying thereafter, it cannot be represented as a provision which only applies to taxpayers who could have known of this ruling, even if it were deemed to constitute "notice."

The Government also suggests that a fiduciary's action in reporting Project Notes as taxable on the estate tax return is evidence that the decedent had no expectation that the Project Notes would be tax exempt (and thus, presumably, that in some sense there was notice). As discussed above at 16-18, a decedent cannot prepare his own estate tax return, and any reporting position taken on the return by the fiduciaries therefore cannot indicate the decedent's expectations.

In its Brief, the Government repeatedly refers to *Haffner* as having been incorrectly decided and implies that, before *Haffner*, no taxpayer could have had any expectation that the Project Notes would be tax-exempt. This argument is belied by the fact that the *Haffner* decision was the direct result of litigation initiated by a fiduciary who had filed the estate's tax return with the obvious "expectation" that Project Notes were exempt from Federal estate tax. Furthermore, if no taxpayer had any reason to raise this issue, the Internal Revenue Service would have had no reason to issue Revenue Ruling 81-63. Indeed, internal Service memoranda show that as early as 1953, the Service itself believed that the Project Notes might be exempt from Federal transfer taxes.[15]

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[15]The Government also argues that, with only two exceptions (life insurance proceeds and foreign real estate), the estate tax provisions have never excluded any specified types of property from the gross estates of taxpayers. This is incorrect. For example, until recently, certain retirement benefits payable under qualified plans, tax sheltered annuities, IRAs, and certain military retirement plans were excluded. See 26 U.S.C. § 2039 prior to amendment by DEFRA Section 525. Recently, a portion of proceeds from the sale of employer securities to employee stock ownership plans or worker owned cooperatives has been excluded. See 26 U.S.C. § 2057.

If one examines 132 Cong. Rec. No. 84, 7902-7912, 7959-62 (June 19, 1986), one cannot help but be impressed by the similarity of the public policy considerations in connection with the ESOP exclusion as articulated by Senator Long, and the situation in connection with the Housing Act of 1937. *See also* H.R. Rep. No. 99-841, 99th Cong., 2d Sess. at 4638-4648.

Finally, it is clear that in contrast to *Darusmont*, *supra*, this case involves not a mere change in rates, but what is effectively a new tax. DEFRA Section 641(a) imposes the Federal estate tax on previously untaxed Project Notes. *See Netsky*, *supra*. The Government's position that the elimination of an exemption does not qualify as a new tax is totally unsupportable. Carried to its logical conclusion, this position would hold that Congress could also tax the income earned on the Project Notes in prior years (especially since the standard for retroactive application of income taxes is less rigorous than that for estate taxes). Indeed, the Government's argument would apply with equal force to other tax-exempt bonds. Thus, in effect, the Government is arguing that the unlimited retroactive repeal of Internal Revenue Code Section 103 (the exemption for income earned from State and local bonds) would be constitutional because it would merely remove an exemption, rather than impose a new tax.[16] Such sophistry is clearly contrary to the holding of this Court in *Untermeyer*.[17]

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[16]This example is given for illustrative purposes only. Assuming only for purposes of argument that such a tax would be permitted on a prospective basis, it still appears clear that it could not apply on an unlimited retroactive basis. *Cf.* § 1311 of the Tax Reform Act of 1986, which made various new restrictions or requirements imposed on tax exempt bonds applicable only to those bonds issued after the 1986 effective date.

[17]The Government attempts to bolster its argument that retroactive estate taxes may be imposed without notice by modifying a statement from Judge Learned Hand's opinion in *Cohan v. Commissioner*, 39 F.2d 540, 543 (2d Cir. 1930). The Government argues that "the possibility that Congress will make a change in applicable tax exemptions is one that is always present in our system . . . ." (Brief for Appellant, 33) In support of this proposition, it then quotes Judge Hand as saying that the taxpayer "must be prepared for such possibilities, the [estate tax] system being already in place." (Actually, the quotation reads "the system being already in operation.") This is a complete mischaracterization of the issue in *Cohan*. Contrary to the implication arising from the bracketed words inserted by the Government, Judge Hand was dealing with *a change in income tax rates*, retroactive from the date of enactment to January 1 of the year of enactment. The government's distortion of Judge Hand's remarks ignores the fact that estate and gift tax cases have applied a different, higher standard for justifying retroactive application. Indeed, Judge Hand stated as much: "It appears to us that there is a valid distinction between the taxation of incomes and of gifts or testamentary transfers." *Id.* at 545. He also noted that "transactions, untaxed when they took place, connot be reached by a later statute, certainly when not in contemplation at the time." *Id.*

The Government, in attempting to overcome these defects, argues that the retroactive application of DEFRA Section 641 to Appellees does not violate due process because Congress, in Section 641, merely "ratified" the alleged preexisting "universal understanding" of the old law. (Brief of Appellant, 32, 35) But no basis is shown for the statement that such a "universal understanding" existed. Certainly the taxpayers, as well as the court, in *Haffner* did not agree. Presumably, Congress itself did not believe so or it would not have left the question of the proper construction of the 1937 Act for the courts to decide. Indeed, it is difficult to see how Congress can be said to have ratified any position under the 1937 Act, since it left proper construction of that Act to the courts. At most, under the Government's stated construction of DEFRA Section 641, all Congress did was to preclude certain taxpayers from receiving refunds regardless of whether, on the merits, those taxpayers would be entitled to the refunds. This Court has specifically held in closely analogous circumstances that, even if there were a widespread perception that a given tax was applicable, such perception of a requirement to pay tax which does not legally exist cannot serve as the basis for retroactive "ratification" by the legislature. *See Forbes Pioneer Boat Line v. Board of Commissioners*, 258 U.S. 338 (1922).

In *Forbes Boat Line*, the Board, an administrative authority, collected tolls for passage through the locks of a canal with no existing legislation authorizing that collection; under the state law as it existed at the time, there was not any charge for using the canal. On the date of the state supreme court's decision that the toll had been illegally collected, the state legislature passed a law purporting to ratify retroactively the tolls collected, in addition to imposing the toll prospectively. On rehearing, the state supreme court held that the plaintiff had lost its right to a refund by virtue of the retroactive legislation.

This Court reversed, holding that this attempt to impose a tax retroactively, enabling the administrative authority to keep the money it had collected but to which it was not legally entitled at the time of collection, violated the taxpayer's right to due process. *Id.* at 339-340. The legislation at issue in this case is like that considered in *Forbes Boat Line*, because Congress was not ratifying or attempting to ratify any preexisting general law here; rather, it specifically left the old law as it found it *except* as to amounts already paid by some taxpayers, which it sought to retain by enacting the new law retroactively as to those payments only. As the Court concluded in *Forbes Boat Line*, "[to] say that the Legislature simply was establishing the situation as both parties knew from the beginning it ought to be would be putting something of a gloss on the facts. We must assume that plaintiff went through the canal relying upon its legal rights and it is not to be deprived of them because the Legislature forgot." *Id.* 340.

The Government has also suggested that DEFRA Section 641 does not act retroactively at all, because it merely "clarifies" the law in accordance with the longstanding view of the Treasury and tax practitioners, citing *Commissioner v. Fisher*, 327 U.S. 512 (1946), and *Commissioner v. Wheeler*, 324 U.S. 542 (1945). It is difficult to see how Congress can be said to have clarified anything with regard to pre-effective date transfers, given that it in effect "decided not to decide," leaving the interpretation of Section 5(e) of the 1937 Act to the courts. At any rate, the decisions in *Wheeler* and *Fisher* are readily distinguishable and offer no support for the proposition which the Government advances.[18]

[18]Both cases dealt with the proper definition of the term "earnings and profits" under the Revenue Act of 1934 and succeeding statutes. Because the Act did not specifically define the term, Treasury issued a regulation which by its terms disposed of the issue before the Court. However, courts had refused to apply the regulation. Before the issue reached the Supreme Court, Congress enacted a statute clarifying the law, by adopting the substance of the disputed regulation. In so doing, Congress provided that the clarification would have no effect on any case pending or theretofore decided. In *Wheeler*, this Court held that the regulation itself was valid; therefore, that it had no need to rely on the subsequent statutory clarification, and thus, that no question of retroactivity was presented. In *Fisher* this Court rejected the argument that in excluding pending cases from the reach of the clarifying provision, Congress intended to grant an exemption to taxpayers involved in such litigation while denying it to everyone else. Rather, the Court held, Congress meant what it said and merely intended that the clarification was not to affect the prior law for those taxpayers — which, as seen in *Wheeler*, imposed the tax at any rate. Clearly, neither case has any bearing on whether the statute in question is retroactive — as interpreted by the Government, it undoubtedly is — or whether such retroactive application is unconstitutional.

Perhaps recognizing the lack of support provided by *Wheeler* and *Fisher*, the Government further cites three recent cases which it claims support its position: *New England Baptist Hospital v. United States*, 807 F.2d 280 (1st Cir. 1986); *Canisius College v. United States*, 799 F.2d 18 (2d Cir. 1986), *cert. denied*, No. 86-1187 (April 20, 1987); *Temple University v. United States*, 769 F.2d 126 (3d Cir. 1985), *cert. denied*, No. 85-1401 (June 16, 1986). On the surface, these cases seem somewhat similar to the case at bar, since they concern a congressional decision to prevent taxpayers who had already paid taxes from seeking refunds by making a statute's effective date retroactive for such taxpayers. In light of the discussion contained at part II.B.1 of this Argument, dealing with the denial of taxpayers' rights to judicial review, the validity of these cases, upholding the retroactive legislation against attack on due process grounds, is questionable at best. Even accepting their holdings for purposes of argument, however, they are so different on their facts from this case that they offer no meaningful support for the Government's position.

All of these cases deal with the same factual background. For many years, the Commissioner had taken the position that the term "wages" for purposes of 26 U.S.C. § 3121 (enacted as part of the Federal Insurance Contributions Act, otherwise known as Social Security ("FICA")) was broader and more inclusive than the term as used in the Federal income tax statutes. Specifically, Revenue Ruling 65-208, 1965-2 C.B. 383, held that amounts withheld from an employee's wages under certain salary reduc-

tion agreements and used to purchase tax-sheltered retirement annuities were wages for purposes of Section 3121, even though they did not constitute wages for income tax purposes.

In 1981, this Court decided that the value of meals and lodging provided to employees for the convenience of employers did not constitute wages for FICA purposes, and that, generally, the term "wages" had the same meaning whether used in the income tax or FICA context. *Rowan Cos. v. United States*, 452 U.S. 247 (1981). In 1983, Congress, while accepting the narrow holding of *Rowan* that meals and lodging were not FICA wages, acted to prevent the reasoning of *Rowan* from being applied to other employee receipts, which it feared could substantially narrow the FICA wage base. It specifically provided that amounts paid for annuity contracts under a salary reduction agreement would be included in the FICA wage base, and further enacted a "decoupling" provision holding that the definition of wages for FICA purposes was not to be determined by reference to definitions of the term arising in the income tax context. These amendments were originally prospective but, in 1984, as part of DEFRA, Congress made the decoupling provision retroactive in the case of taxpayers who had treated such amounts as wages on their employment tax returns. *See* DEFRA § 2862(g).

Temple, supra, held that even before the statutory amendments, the amounts in question were wages for FICA purposes. Therefore, it was not necessary to consider questions of retroactivity. As an alternate holding, however, it determined that the retroactive features of the 1984 amendments were not unconstitutional. *Canisius College* and *New England Baptist Hospital* rejected the *Temple* court's holding concerning the pre-DEFRA definition of wages but agreed that DEFRA retroactively included the amounts as wages for those taxpayers who had filed returns on that basis, and that such retroactive application was not unconstitutional. These decisions, however, even if correct, must be read in the proper statutory context. They deal with FICA taxes, which, as the Government itself has argued, are a world apart from the issue of estate tax retroactivity. (*Temple*, Government's Brief in Opposition to Petition for Certiorari, at 13, n. 3) This is

because FICA taxes are, in the first place, more closely akin to income taxes than estate taxes. The extent to which taxpayers can "plan" for income-related taxes, including FICA taxes, is much more limited than in the estate-planning context. *See Darusmont, supra; Untermeyer, supra.* Therefore, as discussed above, the courts have always required a stricter due process standard for retroactive estate tax provisions than for income tax provisions.

Secondly, the Courts of Appeals emphasized the longstanding administrative practice, evidenced by a revenue ruling that had stood for eighteen years without challenge, in holding that the congressional action was merely a clarification of the law. In our case, in contrast, Revenue Ruling 81-63 had been promulgated for only two years before the estate tax return was filed and approximately three years before congressional action. Thus, there is no longstanding administrative practice or assumption present in this case.

Most important, the two-sided "insurance" function of FICA means that changes in "wage" exclusions or inclusions directly affect not only taxes but also benefits. In a sense, the FICA taxes serve as insurance premiums. The retroactive action taken by Congress would not only prevent refunds of taxes paid, but would also prevent reduction in benefits already paid, currently payable, or payable in the future. This dual effect was of major importance to Congress in creating the retroactivity (H.R. Rep. No. 98-432, 98th Cong., 2d Sess., Pt. II at 1658 (1984); S. Rep. No. 98-23, 98th Cong., 1st Sess., at 42), as well as to the Court of Appeals, in finding no due process violation. It was emphasized by the Government itself in arguing against review of those decisions by this Court. (*Temple,* Brief in Opposition, at 13-14; *Canisius,* Brief in Opposition at 11)

As this Court stated in *Hemme, supra,* in order for a violation of due process to occur, a deprivation must occur. Under the FICA system, the retroactive preclusion of refunds of taxes paid obviously prevents employers and employees from recovering taxes erroneously paid. But given the insurance function described above, this is only a timing difference, and any benefit to

employees from receiving tax refunds would be outweighed by the necessarily corresponding decrease in their wage base and future benefits. Even employers would probably realize little, if any, actual benefit from the refunds, in light of the administrative costs they would incur to return to present and past employees their share of the refunds. Therefore, the Government could argue that, as in *Hemme,* employees as well as employers were actually better off under the new law, retroactivity notwithstanding; no such argument can be made in our case. In addition, the administrative nightmare in which the Social Security system would find itself embroiled in trying to account for past taxes paid and refunded to both employers and employees, with the necessary massive recalculation of past wage bases and past, present and future benefits, would quite simply be staggering — far beyond the simple (even if unpleasant, to the Government) task of refunding illegally collected taxes which is involved in the present case.

Simply put, comparing the social insurance system to the estate tax system is fruitless, and any authority ratifying retroactive provisions with respect to the former can have little or no application to the latter. Even if Congress did intend to bar refunds with all their accompanying effects, it is clearly much more difficult to conclude that such intended action is "irrational," or "harsh and oppressive," than it is in a case such as the present one, involving a simple refund of transfer taxes illegally collected.

In conclusion, the Government's interpretation of DEFRA Section 641(b) would have the untenable result of sanctioning unlimited retroactivity of estate tax statutes and would be harsh, arbitrary and unfair. It is harsh and oppressive to impose a tax on a new class of property when the decedent, who could have altered his behavior had he known that the tax would be imposed, had no notice that such would be the case. Moreover, the unlimited retroactivity claimed by the Government is without precedent and in itself would constitute a denial of due process.

III.

THE PROJECT NOTES WERE EXEMPT FROM TAXATION UNDER THE PROVISIONS OF THE 1937 ACT.

Having established that DEFRA Section 641(b)(2) cannot preclude Appellees from asserting the position that the Project Notes are exempt from estate taxation, the issue remains as to whether that position is correct on the merits — *i.e.,* whether the Project Notes are subject to the Federal estate tax. But it is not clear that this Court should address that issue at this time.

A. This Court Should Exercise Its Sound Discretion So As to Avoid a Premature and Unnecessary Ruling Concerning the Merits of Appellees' Claim under Section 5(e) of the 1937 Act.

This Court's jurisdiction here is based on 28 U.S.C. § 1252, which provides for direct appeal from any decision by a court of the United States holding an Act of Congress unconstitutional in a civil action to which the United states is a party. The court below held DEFRA Section 641(b)(2) unconstitutional, and therefore an appeal to this Court properly lies. But this Court can dispose of the constitutional issue presented without the need to answer the accompanying question of statutory construction involving taxability of the Project Notes. Thus, no decision on the substantive merits of Appellees' claim is necessary.

The Government cites authority holding that an appeal under 28 U.S.C. § 1252 may operate to bring the entire case before the Court, including relevant nonconstitutional questions. This is undoubtedly correct. The reason for this rule is that it allows the Court to exercise restraint and to apply its established prudential practice of ascertaining whether a nonconstitutional ground is available which would obviate the necessity of ruling on the constitutional question presented. Whether or not the Court chooses to rule on a given nonconstitutional issue turns on the Court's discretion, and there is no rule that every issue presented in the proceedings below must be resolved by this Court.

In this case, there is no compelling reason for this Court to exercise its discretion and consider the statutory construction of the 1937 Act. This is because the District Court's decisions can be affirmed on nonconstitutional grounds. As discussed in part I of this Argument, above, DEFRA Section 641(b)(2) should be read to allow Appellees to prosecute their claim on the merits, because the more appropriate construction of that provision is that it is retroactive only to the effective date of the provision resulting in the enactment of that section. If such a reading is adopted, the constitutional question becomes moot in this case, and consideration of the proper construction of Section 5(e) of the 1937 Act would become not only premature but unnecessary. Indeed, the sole issue which gave this Court jurisdiction in the first instance would no longer be present.

Appellees respectfully submit under these circumstances that this Court should hold that DEFRA Section 641(b)(2) does not preclude Appellees from asserting their claim of tax exemption on the merits, thereby vacating the District Court's holding that Section 641(b)(2) is unconstitutional. On remand, the Government could, if it desired to continue to assert its position that *Haffner* was wrongly decided, appeal the District Court's decision on the merits to the Court of Appeals in accordance with normal appellate procedures. This approach would conserve this Court's time and allow the law concerning the proper construction of Section 5(e) of the 1937 Act to evolve in a natural manner. If, eventually, it becomes apparent that the Courts of Appeals are divided on the question, this Court could exercise its discretion to grant certiorari and resolve the issue. But it may well be that such action will never become necessary.

B. The Court Below Was Correct in Following Haffner to Hold that the Project Notes Were Exempt from the Federal Estate Tax.

If this Court should choose to exercise its discretion and address the *Haffner* issue on the merits, it should affirm the court below.

The case for holding that bonds issued under Section 5(e) of the Housing Act of 1937 are exempt from estate taxation is simple. That provision states in pertinent part:

> [O]bligations, including interest thereon, issued by public housing agencies in connection with low-rent-housing or slum-clearance projects, and the income derived from such projects shall be exempt from *all taxation now or hereafter imposed.* (Emphasis supplied)

In response to this seemingly clear language, the Government cites a line of cases and Reg. § 20.2033-1, which hold that a general statement of tax exemption, without more, does not confer exemption from estate and gift taxes, because such taxes are imposed on the transfer of the property involved, not the property itself. (Brief for Appellant, 14-15) But clear authority also provides that, where there is a strong indication from the language of the statute involved and its legislative history that Congress intended an exemption from "all taxation" to encompass such transfer taxes, the specific Congressional intent must override the general rule cited by the Appellant. *See Jandorf's Estate v. United States*, 171 F.2d 464 (2d Cir. 1948); *Green v. United States*, 171 F.Supp. 459 (Ct.Cl. 1959); *Haffner, supra*. Such a strong indication exists in this case and therefore the Project Notes cannot be included in a decedent's taxable estate.

Section 5(e) is only one component of the 1937 Act. In general, the 1937 Act created an agency of the United States, known as the United States Housing Authority, whose purpose was to make available funds and credit to assist State and local governments in the provision of low income housing and in the elimination of substandard housing. Section 5(e) of the Act, quoted above, furthered these purposes by exempting obligations of *local housing agencies* from "all taxation." In contrast, Section 20(a) of the same Act authorized the United States Housing Authority to issue obligations, and Section 20(b) granted a tax exemption to such *Federal* obligations. Section 20(b)'s language, however,

differed in one significant respect from that contained in Section 5(e):

> Such obligations, shall be exempt, both as to principal and interest, from all taxation *(except surtaxes, estate, inheritance and gift taxes)* now or hereafter imposed. . . .
> (Emphasis supplied)

The distinction emphasized above is crucial. Congress in two closely-related provisions of the same statute chose to use significantly different language. If the Government's argument is accepted, this difference in effect would be inadvertent and meaningless. But Congress cannot be presumed to have used language idly. In determining the intent of Congress, a court should construe a statute so as to give operative effect to every clause. *Market Co. v. Hoffman*, 101 U.S. 112, 115-116 (1879); *Adler v. Northern Hotel Co.*, 175 F.2d 619, 621 (7th Cir. 1949); *American Bank & Trust Co. v. Dallas County*, 463 U.S. 855 (1983). Moreover, the various sections of a statute "should be presumed to have been drafted with reference to one another; the whole statute is the context for construction of any of its individual sections. *See, e.g., United States v. American Trucking Association*, 310 U.S. 534, 542-44 (1940)." *Haffner*, 585 F.Supp. at 358.

Thus, the different language contained in the two exemption provisions must have some meaning, and that meaning should be discerned by reference to the relationship between the two provisions. The only plausible explanation is that obligations of the Federal agency were to be treated differently, as regards tax exemption, from obligations of the local agencies. Section 20(b) clearly provided that Federal obligations were not exempt from surtaxes, estate, inheritance, and gift taxes. Since comparable language did *not* modify Section 5(e)'s exemption from all taxes, the only logical conclusion is that obligations covered by Section 5(e) — such as the Project Notes — must be exempt from estate, inheritance, and gift taxes.

This conclusion is fully supported by the authoritative statement of Senator Walsh, explaining the bill which became the 1937

Act on the floor of the Senate. There is no ambiguity about the language he chose to describe the exemption contained in Section 5(e):

> Obligations, including interest thereon, issued by public housing agencies, and income derived by such agencies on such projects are to be exempt from all taxation now or hereafter imposed by the United States. In other words, the Bill gives the public housing agencies the right to issue tax-exempt bonds, *which means they are free from income tax, surtax, estate, gift and inheritance taxes.*

81 Cong.Rec. 8085 (1937) (emphasis supplied).

Not only is this a clear and unambiguous statement, but the choice of precisely the terms used in the parenthetical exception contained in Section 20(b) ("surtax, estate, gift and inheritance taxes") is evidence that Senator Walsh was well aware of the differing language of the two provisions and wished to emphasize their differences on the Senate floor.[19]

Furthermore, Mr. Warren Vinton, chief economist of the newly-created National Housing Authority, unequivocally declared the Agency's understanding that Congress intended to exempt Project Notes from transfer taxes. See the address he gave, explaining the impact of the Act to members of the American Federation

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[19]The courts in *Haffner* and the court below relied also on two additional factors in holding that the Project Notes were exempt from the estate tax: (1) the presence in a prior version of the 1937 Act, which was not enacted, of language explicitly excluding Federal estate taxes from the general tax exemption contained in Section 5(e), and (2) the closely analogous case of *Jandorf's Estate v. Commissioner*, 171 F.2d 464 (2d Cir. 1948). Appellees agree that both items support their position and would refer to the opinion of the District Court in *Haffner* for a more thorough discussion of these points. In light of the clear statutory language and the unambiguous and unchallenged statement of Senator Walsh, however, Appellees submit that it is unnecessary to discuss these additional supporting points in any great detail.

of Housing Authorities, Inc. at its conference of September 24-25, 1937. Mr. Vinton stated:

> Mind you, the obligations of the local Authorities — and a mortgage bond is an obligation of a local Authority — are exempt from all federal taxes, not only normal income taxes but surtax, inheritance tax, and gift tax. Investments of that nature are getting rare in the country. They are at a premium. The mortgage obligation of the local Authorities ought to command a ready market. I should hope that as soon as investors are used to that form of obligation you ought to borrow money for 3 to 3¼%.

American Federation of Housing Authorities, Inc., *Summary Report of Conference of September 24-25, 1937*, held at the office of the Federation at the Hay-Adams House, 730 Jackson Place, Washington, D.C.

Mr. Vinton's views are especially relevant because he was a major administration spokesman who not only supported the bill that was to become the Housing Act, but actually assisted Congress in drafting the Act. It is well established that a contemporaneous interpretation of an official charged with administering and interpreting a statute is entitled to great weight in determining congressional intent. See *United States* v. *Board of Commissioners*, 435 U.S. 110, 131 (1978). In light of the presence of the local housing authority representatives and the administration's desire that the local authorities sell the newly issued Project Notes, there can be little doubt but that the Notes were to be exempt from transfer taxes.

In the face of the decisive evidence discussed above, the Government can only argue that the parenthetical exception included in Section 20(b) was necessitated by the desire to make clear that interest on Federal Housing Authority obligations, unlike interest on the obligations issued by State and local authorities under Section 5(e), was to be subject to the Federal income tax surtax. (Brief for Appellant, 21.) Thus, the Government has in effect conceded that the difference between the two

provisions is meaningful and fully intended by Congress. It also concedes, as Appellees urge, that the scope of the exemption is greater for obligations issued by State and local agencies than for obligations issued by the Federal agency. But, while conceding all these points, the Government refuses to concede that the Project Notes are exempt from the estate tax. In other words, the fact that Congress specifically exempted the surtax is to be considered meaningful, but the specific inclusion of the estate tax in the same parenthetical phrase is to be ignored.

In an attempt to escape this inconsistency, the Government offers the ingenious explanation that the words "estate, inheritance and gift taxes" were included only in a wise attempt to foreclose any attempt at an "*expressio unius est exclusio alterius*" argument that the Authority's obligations would be exempt from the estate tax. But such a provision should be totally unnecessary in light of the Government's assertion that use of the phrase "all taxation" excludes the estate tax at any rate. If Congress really intended such subtlety, it could have eliminated all controversy by including a similar phrase, *sans* the surtax exemption, in Section 5(e). In brief, the Government argues that plain language means what it says when helpful, but not when it would provide an exemption from estate taxes. Significantly, the Seventh Circuit Court of Appeals considered this argument and rejected it in affirming and adopting (with modifications) the District Court's opinion in *Haffner*. *See* 757 F.2d at 922 (Judge Posner's dissent).

Moreover, the Government's position is clearly belied by Senator Walsh's floor statement, alluded to earlier. To avoid the inevitable conclusion that Senator Walsh meant what he said when he stated that obligations such as the Project Notes were exempt from the estate tax, the Government suggests that the Senator was uninformed about the general rule concerning tax exempt bonds and meant to say merely that Section 5(e) conferred the same exemption enjoyed by other unrelated bonds. This is unsupported speculation, contradicted by Senator Walsh's clear language.

First, as pointed out by the *Haffner* court, Senator Wagner, who was primarily responsible for the Bill, did not hesitate to interject when Senator Walsh did misstate the Bill's provisions. 585 F.Supp. at 359, n. 5; 81 Cong.Rec. 8081. Senator Wagner said nothing when Senator Walsh stated that the public agency bonds were exempt from the estate tax. Surely he would have noted such a fundamental and far-reaching error, if it had been an error. Even if Senator Wagner chose this impropitious time to let his attention wander, it is unlikely that not one of the Senators present would have questioned Senator Walsh's statement, if indeed it was contary to what they intended to vote for.

Second, it seems beyond coincidence that in describing the Section 5(e) tax exemption Senator Walsh would by total inadvertence use the precise language contained in the Section 20(b) parenthetical exemption had he not wished to emphasize the differences between the two provisions.

Third, the contemporaneous administrative construction of the body charged with administering the Housing Act confirms Senator Walsh's plain language.

Congress clearly showed its intention that the Project Notes would be exempt from the estate tax as well as other taxes when it enacted the 1937 Act. The Government's real objection to the decision of the court below is that it does not like this policy decision, because it would result in lost tax revenues and "undeserved windfalls" to taxpayers. The Government raises these policy concerns to support its contention that this Court should at this late date deny the estate tax exemption. But, while these concerns might justify a prospective change in law, they cannot override the clear statement of congressional intent contained in the 1937 Act and accompanying legislative history.

Therefore, it should not matter whether this Court believes that it was wise for Congress to have granted an estate tax exemption for the Project Notes; if, as Appellees have argued, that is what Congress intended at the time, the courts should not substitute their subjective beliefs concerning the merits of the legislation for this congressional intent. It is not the role of the courts in our

system to legislate, to remedy legislative omissions, or to rewrite statutory language. *See Iselin v. United States*, 270 U.S. 245, 251 (1926); *Smietanka v. First Trust & Savings Bank*, 257 U.S. 602, 605-606 (1922). *See also United States v. Locke*, 471 U.S. 84, 91 (1985).

Thus, the Government's argument that there is a "windfall" to Appellees, even if true, could have no bearing on the proper interpretation of Section 5(e) of the 1937 Act. "[W]here the benefit claimed by the taxpayer is fairly within the statutory language and the construction sought is in harmony with the statute as an organic whole, the benefits will not be withheld from the taxpayer though they represent an unexpected windfall." *Lewyt Corp. v. Commissioner*, 349 U.S. 237, 240 (1955). *See also, Hanover Bank v. Commissioner*, 369 U.S. 672, 687 (1962). Likewise, even a subsequent congressional change of heart concerning a prior legislative action cannot be used to change the meaning of the prior act. Even if the Congress which enacted DEFRA were to have unambiguously stated what it felt the proper interpretation of Section 5(e) of the 1937 Act should be (an action which it wisely avoided, leaving the issue to be resolved by the courts), a subsequent Congress is "as likely to be wrong as anyone else, and in the end the courts must decide." *American Exchange Securities Co. v. Helvering*, 74 F.2d 213 (2d Cir. 1934). For these reasons, if this Court reaches this issue, it should affirm the holding of the court below that the Project Notes were exempt from estate tax under Section 5(e) of the 1937 Act.

CONCLUSION

This Court should hold that DEFRA Section 641(b)(2) does not apply to Appellees, and remand the case for disposition not inconsistent with this Court's decision. In the alternative, this Court should affirm the judgment of the District Court.

Respectfully submitted,

MARK G. ANCEL
Attorney for Appellees

PROOF OF SERVICE BY MAIL

I am a citizen of the United States and a resident of the City and County of Los Angeles; I am over the age of eighteen years and not a party to the within action; my business address is: 1706 Maple Avenue, Los Angeles, California.

On October 27, 1987, I served the within Appellees Brief in re: "United States of America vs. Wells Fargo Bank" in the United States Supreme Court, October Term 1987, No. 86-1521;

On the Parties in said action, by placing Three copies thereof enclosed in a sealed envelope with postage fully prepaid, in the United States post office mail box at Los Angeles, California, addressed as follows:

Charles Fried, Solicitor General
Michael C. Durney, Acting Assistant Attorney General
Albert G. Lauber, Jr., Deputy Solicitor General
Alan I. Horowitz, Assistant to the Solicitor General
Michael L. Paup
Ernest J. Brown
David I. Pincus
Department of Justice
Washington, D.C. 20530

All parties required to be served, have been served.

I certify (or declare), under penalty of perjury, that the foregoing is true and correct.

Executed on October 27, 1987, at Los Angeles, California

STEVEN RESNICK

REPLY

BRIEF

No. 86-1521

Supreme Court, U.S.
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CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1987

UNITED STATES OF AMERICA, APPELLANT

v.

WELLS FARGO BANK, ET AL.

UNITED STATES OF AMERICA, APPELLANT

v.

HARRY ROSENBERG AND ARTHUR ROSEN, ETC.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE CENTRAL DISTRICT OF CALIFORNIA

REPLY BRIEF FOR THE UNITED STATES

CHARLES FRIED
Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 633-2217

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In the Supreme Court of the United States

OCTOBER TERM, 1987

No. 86-1521

UNITED STATES OF AMERICA, APPELLANT

v.

WELLS FARGO BANK, ET AL.

UNITED STATES OF AMERICA, APPELLANT

v.

HARRY ROSENBERG AND ARTHUR ROSEN, ETC.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE CENTRAL DISTRICT OF CALIFORNIA

REPLY BRIEF FOR THE UNITED STATES

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1. Appellees' fundamental contention is that the Housing Act of 1937 exempted Project Notes from the federal estate tax; the district court's decision cannot be affirmed unless appellants prevail on this statutory contention. As we explained in detail in our opening brief (at 15-35), however, and as the Tax Court recently held in a reviewed decision (*Estate of Egger* v. *Commissioner*, 89 T.C. No. 50 (Sept. 30, 1987)), this contention is untenable. The language of Section 5(e) of the Housing Act of 1937, ch. 896, 50 Stat. 890, does not support appellees' position. As even the district court in *Haffner* v. *United States*, 585 F. Supp. 354 (N.D.Ill. 1984), acknowledged (see *id.* at 356-357), the statutory phrase making obligations " 'exempt from all taxation' " is one that "had been definitively interpreted by 1937" (*Estate of Egger*, slip op. 9), and it was never regarded as establishing an exemption from

estate taxes. Rather, that language establishes no more than that the obligations themselves and the interest thereon are exempt from direct taxation; it does not address transfer taxes like the gift and estate taxes. This well-established distinction is not an "implied exception" to a blanket tax exemption (cf. Wells Fargo Br. 16, 20), but rather a construction of the statutory language based on the fact that estate and gift taxes are not direct taxes on the obligations themselves, but rather are excise taxes upon the *transfer* of property. See, *e.g.*, *Murdock* v. *Ward*, 178 U.S. 139, 145 (1900); U.S. Br. 18 & n.7.

In relying upon "ambiguous tidbits" of legislative history (see *Haffner* v. *United States*, 757 F.2d 920, 922 (7th Cir. 1985) (Posner, J., dissenting)) to justify their claim of an estate tax exemption (Wells Fargo Br. 8-23; Rosenberg Br. 39-45), appellees ignore the well-settled proposition that "[e]xemptions from taxation do not rest upon implication" (*United States Trust Co.* v. *Helvering*, 307 U.S. 57, 60 (1939) (footnote omitted)). Moreover, the fundamental requirement that an intent to create a tax exemption must be clearly expressed by the taxing power is particularly strong in this context because the exemption claimed by appellees is so antithetical to tax principles consistently followed by Congress. A transfer tax exemption for a particular type of property creates a conspicuous opportunity for a taxpayer to evade the tax simply by converting his property into the exempted type shortly before making the transfer. For this reason, except for two narrow and long-repealed exceptions (see U.S. Br. 16 n.6), Congress has never established estate tax exemptions for specific types of property owned by the decedent.[1] And

[1] Appellees suggest that estate tax exemptions for specified types of property have not been so limited (Rosenberg Br. 29 n.15). But unlike Project Notes, the property cited by appellees, such as survivorship annuities purchased by the employer, is not property owned by the decedent, and it was not generally viewed as includible within the

it would have been especially odd for Congress to have enacted such a substantial estate and gift tax loophole in 1937 when the general thrust of its tax policy at that time was to reduce concentrations of wealth by strengthening the estate and gift taxes (see *Estate of Egger*, slip op. 13-14).[2] If Congress truly had intended such a marked departure from its ordinary tax exemption structure by establishing an almost unprecedented estate tax exemption for Project Notes, it is hard to believe that Congress would not have made its intentions explicitly clear in the statute and that the legislative history would not have noted this important and extremely unusual feature of the Housing Act of 1937.[3]

gross estate under the terms of the predecessor sections of Sections 2031 and 2033 of the Code (26 U.S.C.). Congress in 1954 moved to treat such annuities as taxable transfers by enacting Section 2039(a) of the Code, though at that time it provided in Section 2039(c) for the exclusion of survivorship annuities paid under *qualified* employee plans. Whether or not such employer-purchased annuities are included in the gross estate obviously is a question of different magnitude than the exclusion of a particular type of property owned by the decedent from the gross estate, since the latter type of exclusion allows the taxpayer to avoid estate or gift tax by timely conversion of his assets into the excluded type of property.

[2] By the same token, the establishment of a federal estate tax loophole that one leading member of the private tax bar has stated could lead to " 'failure of the transfer tax program in the U.S.' " (Wash. Post, June 13, 1984, at F3, col. 1) would hardly have been a reasonable way for Congress to ameliorate a concern about "placing the entire burden of financing low income housing on the federal government" (Wells Fargo Br. 9).

[3] Appellees suggest (Wells Fargo Br. 18 n.5) that an estate tax exemption for Project Notes should not be regarded as unusual in light of the fact that the Notes undisputedly were exempted from the surtax. The premise of this suggestion is faulty. It is true that surtax exemptions for *federal* obligations were not the norm, though they were hardly as rare as estate tax exemptions (see U.S. Br. 26-27 & n.14). But Project Notes were not federal obligations. They were obligations of

In any event, quite apart from the special reasons that weigh heavily against implying an estate tax exemption here, the legislative history relied upon by appellees provides little, if any, reason to suppose that Congress intended to confer upon Project Notes a tax exemption different in scope from that of other state and municipal obligations. As set forth in detail in our opening brief (at 22-27), the difference in language between Sections 5(e) and 20(b) of the Housing Act of 1937 (50 Stat. 890, 898) is "reasonabl[y] and persuasive[ly]" explained by the different purposes underlying the two sections (see *Estate of Egger,* slip op. 11). In light of the fact that the two sections were drafted in different years and almost certainly by different people, it is immaterial that, as appellees suggest (see Wells Fargo Br. 17-18; Rosenberg Br. 39-40, 43), a draftsman comparing the two sections side-by-side might have been inclined to make more explicit in Section 5(e) an intent to subject Project Notes to estate taxation.[4] What is significant is that in Section 5(e) Congress used

state and municipal bodies, which, in deference to principles of intergovernmental immunity, were routinely exempted entirely from the federal income tax, including the surtax. Compare Revenue Act of 1936, ch. 690, § 22(b)(4), 49 Stat. 1657, with *id.* § 25(a), 49 Stat. 1662-1663. Thus, it was not at all unusual that Project Notes were exempted from the surtax; it would have been remarkable if they had not been so exempted.

[4] We noted in our opening brief (at 30 n.16) that the language of Section 20(b) was contained in a bill introduced by Sen. Wagner in 1936, while the tax exemption for Project Notes did not appear in the bill until 1937. In fact, the language of Section 20(b) first appeared even earlier, in a housing bill introduced by a different sponsor in 1935. Section 5(a) of the Ellenbogen Bill of 1935 (H.R. 7399, 74th Cong., 1st Sess.), *reprinted in* T. McDonnell, *The Wagner Housing Act, A Case Study of the Legislative Process* (1957) [hereinafter McDonnell]; *id.* at 414; see also *id.* at 88-114 for a discussion of the Ellenbogen Bill and the Wagner Bill. It is therefore fallacious to attempt to draw inferences of congressional intent by comparing the text of the two sections as if they were composed by a single person contemporaneously.

statutory language that was universally understood as conferring an exemption from federal income taxation, but not from transfer taxes, and there is no reason to believe that Congress did not intend to adhere to that well-established interpretation.

The statements upon which appellees rely to divine a congressional intent to exempt Project Notes from estate tax (see Rosenberg Br. 40-44; Wells Fargo Br. 12-15, 20-22) are similarly unavailing. As we explained in our opening brief (at 31-34), the statement of Senator Walsh appears to reflect no more than a misstatement of the ordinary properties of "tax-exempt bonds." He stated (81 Cong. Rec. 8085 (1937)): "the bill gives the public housing agencies the right to issue tax-exempt bonds, which means they are free from income tax, surtax, estate, gift, and inheritance taxes." If Senator Walsh had truly believed that Project Notes were being imbued with an unique form of tax exemption, one would expect him to have remarked upon their uniqueness, not to have suggested that they were no different from other tax-exempt bonds.

Moreover, Senator Walsh can hardly be regarded as an "authoritative" (Wells Fargo Br. 21; Rosenberg Br. 40) expositor of the meaning of the Housing Act of 1937. He was not "one of the 1937 Act's strongest supporters" (Wells Fargo Br. 12); to the contrary, he opposed the bill in important respects (see U.S. Br. 33).[5] Moreover, his dis-

[5] In particular, Senator Walsh believed that the government's role should be focused on slum clearance, and he was generally opposed to government construction of housing. See 81 Cong. Rec. 8090-8091 (1937). Indeed, he stated in the 1936 debate on one of the bills that ultimately became the Housing Act of 1937 that "the Government has no business whatsoever * * * in building homes for persons in the low income groups" (80 Cong. Rec. 9558 (1936)). This limited tolerance of government participation in housing was consistent with Senator Walsh's opposition to much of the social and economic legislation of the 1930s; there was a "fundamental conflict" between Senator Walsh and President Roosevelt over the latter's belief in broadening federal power. See D. Wayman, *David I. Walsh, Citizen-Patriot* 209 (1952).

cussion of the bill on the floor of the Senate was replete with errors, many of which were caught and corrected by Senator Wagner (see Note, Haffner *v.* United States: *Does An Exemption From "All Taxation" Granted To Public Housing Agency Bonds Include Federal Transfer Taxes*?, 46 U. Pitt. L. Rev. 821, 834-835 & n.74 (1985)). The mere fact that some of the errors were corrected on the floor of the Senate hardly demonstrates that the rest of his statements were accurate. In short, the failure of anyone on the Senate floor to correct Senator Walsh's erroneous definition of a tax-exempt bond is, to put it mildly, a remarkably slender thread from which to hang the implication of a massive and unprecedented exemption from the estate tax.

Appellees also rely (Wells Fargo Br. 14-15; Rosenberg Br. 41-42) upon a statement in a reported summary of a speech by Warren Vinton, whom they describe as an "actual drafter and administrator of the 1937 Act" (Wells Fargo Br. 14) and as "a major administration spokesman" (Rosenberg Br. 42). These characterizations significantly exaggerate Vinton's role, and his statement cannot bear the weight appellees seek to ascribe to it.

Between 1935 and 1937, Vinton served as an economist at the Resettlement Administration in the Department of Agriculture. He was not a lawyer, and there is no reason to believe that he was familiar with the federal taxation principles reflected in decisions like *Murdock* v. *Ward, supra.*[6]

[6] Indeed, the quoted statement itself reveals Vinton's unfamiliarity with the tax exemption issue that appellees assert should turn on his alleged expertise. Vinton stated that investments that are exempt from what he called the "inheritance tax" (appellees maintain that this reference to the "inheritance tax" should be read to cover the federal estate tax) "are getting rare in the country. They are at a premium." See Rosenberg Br. 42; Wells Fargo Br. 15. Investments exempt from the federal estate tax, of course, were not "getting rare"; they were almost unheard-of. The only example of an investment fitting Vinton's description was an investment in foreign real estate. The estate tax exemption for such real estate had been enacted in 1934 and was repealed in 1962 (see U.S. Br. 16 n.6).

He was not responsible for the language of the Housing Act; Senator Wagner's bills were actually drafted by his legislative assistant, Leon Keyserling, who was both a lawyer and an economist. See McDonnell at 133-134, 256, 260, 265; 1 *Who's Who in America* 1517 (A. Marquis 44th ed. 1986-1987). Vinton was a supporter of the Wagner legislation, and his expertise in the area of low-cost housing made him a frequent and valuable consultant to Senator Wagner and his staff (see, *e.g.*, McDonnell at 253-268). But it was Keyserling who translated the ideas of Vinton and other experts into the drafting of a statute (see, *e.g., id.* at 153-154).

Nor can Vinton reasonably be relied upon as a "spokesman" for the government or as an "administrator." Indeed, although he ultimately did serve as the Chief Economist of the United States Housing Authority, it does not appear that he was even employed by the Authority when he gave the speech relied upon by appellees.[7] Even if

[7] The Housing Act that created the United States Housing Authority was signed into law on September 1, 1937, and the Vinton speech was given on September 24, 1937. It does not appear that the Authority had yet become operative by that time. An address by B.M. Pettit of the Public Works Division noted that "the United States Housing Authority will soon be operative" (American Federation of Housing Authorities, Inc., *Summary Report of Conference of September 24-25, 1937*, at 14, App. at 2 (1937) [hereinafter *Summary*]). The Administrator of the Authority was not appointed until mid-October (N.Y. Times, Oct. 19, 1937, at 1, col. 2), which was during a congressional recess, and he was not confirmed until December 8, 1937 (82 Cong. Rec. 1090-1092 (1937)). It is most unlikely that the Authority's Chief Economist took office before the Administrator was named. Indeed, although the 1939 Congressional Directory (at 339) lists Vinton as the Chief Economist of the Authority, the 1938 Congressional

he had been, his statement surely could not represent an administrative construction of the Act by a responsible agency; quite apart from the informality of the statement, the United States Housing Authority had no responsibility either for issuing Project Notes or for making determinations as to the scope of their tax-exempt status. Thus, Vinton's statement plainly can give no guidance as to Congress's intent in enacting Section 5(e).

2. Appellees contend (Rosenberg Br. 6-13; Wells Fargo Br. 23-30) that Section 641(b)(2) of the Deficit Reduction Act of 1984 (DEFRA), Pub. L. No. 98-369, 98 Stat. 939, should not be construed to apply to this case. Specifically, appellees contend that the statutory language denying an estate tax exemption for Project Notes "if at any time there was filed an estate or gift tax return showing such transfer as subject to Federal estate or gift tax" was intended by Congress to refer only to returns filed at any time after June 19, 1984, *i.e.*, only to returns to be filed in the future after the statute was drafted. This contention was correctly rejected by the district court (J.S. App. 5a-8a), which concluded that "the language of DEFRA Section 641(b)(2) clearly mandates that the statute reach past transfers" (J.S. App. 7a). See also *Estate of Bradford* v. *United States*, 645 F. Supp. 476 (N.D. Cal. 1986), appeal pending, No. 86-2634 (9th Cir.); but see *Netsky* v. *United States*, 652 F. Supp. 783, 785 (E.D. Pa. 1986), appeal pending, No. 86-1616 (3d Cir.). The unmistakable intent of Congress in enacting Section 641(b)(2) was to forestall a flood of refund suits by denying an estate tax exemption to estates that had already reported Project Notes as taxable on their returns.

Directory (at 326), corrected to December 21, 1937, lists only the Administrator and a few other officers and does not include Vinton. Moreover, the Summary Report of the Conference generally introduced the speakers at the Conference with their title (*e.g.*, "Director Of The Resettlement Division" or "Chairman Of The Federal Home Loan Bank Board" (Summary at 7)). Vinton, however, is introduced simply as "Mr. Warren Vinton" (*id.* at 14). In sum, there is no basis for concluding that Vinton was addressing the Conference as a "spokesman" for the Authority.

Appellees principally rely on *Hassett* v. *Welch*, 303 U.S. 303 (1938), and *Shwab* v. *Doyle*, 258 U.S. 529 (1922), two cases in which estate tax legislation intended to operate only prospectively used the phrase "at any time." Those cases are inapposite. In both cases, Congress acted to apply the estate tax to certain property transferred during the decedent's lifetime—in *Shwab*, to gifts in contemplation of death and, in *Hassett*, to transfers retaining a life estate. In each case, the question was whether the statutory language of a single section was intended to apply both prospectively and also retrospectively to transfers before the effective date of the statute or, alternatively, whether it was intended to apply only prospectively. Reasoning that the language of the statute was not "free from doubt" (*Hassett*, 303 U.S. at 309), the Court found that the background and legislative history of each statute gave no indication that Congress intended the changes to apply retrospectively to prior transfers, but rather suggested that the statutes were to operate prospectively.[8]

The statute at issue here is markedly different. Congress enacted a separate subsection, Section 641(b)(1) of DEFRA (98 Stat. 939), to establish the prospective effect of the amendment. Thus, in contrast to *Shwab* and *Hassett*, it is untenable to maintain that Section 641(b)(2), the subsection at issue here, was intended to have only prospective effect; that was already accomplished by Subsection (b)(1), which makes the rule that Project Notes are subject to estate taxation applicable "to the estate of de-

[8] Indeed, the legislative history of the statute involved in *Hassett* contained a specific explanation by a member of the House Ways and Means Committee of the reason why the House chose not to make the statute retroactive (see 303 U.S. at 310).

cedents dying, gifts made, and transfers made on or after June 19, 1984." The plain purpose of Subsection (b)(2) was to proceed to delineate the scope of the retrospective effect of the statute. The language chosen by Congress manifestly demonstrated its intent that Section 641(b)(2) operate retrospectively. The subsection is phrased in the past tense, stating that it applies "if at any time there *was filed*" a return showing the Project Notes as taxable. This would be a most peculiar way of phrasing a statute that is to apply only to returns to be filed in the future. Moreover, the addition of the phrase "at any time" is completely inexplicable if appellees are correct that the subsection was intended to apply only to returns to be filed in the future.[9] Thus, the district court below correctly concluded that "DEFRA Section 641 contains a 'clear, strong and imperative' declaration of retroactivity" (J.S. App. 8a (citation omitted)).

Apart from the clear import of the statutory language, it is apparent that Section 641(b)(2) makes little sense as appellees would construe it. The only cases in which the subsection would apply would be ones in which (1) the decedent died before June 19, 1984; (2) the estate tax return was not filed until after that date; and (3) the estate reported the Project Notes as taxable, although *Haffner* was already on the books and DEFRA provided that this

[9] By contrast, it was reasonable for Congress to insert the words "at any time" in the statutes involved in *Shwab* and *Hassett* even if they were intended to operate only prospectively. Both of those statutes had the effect of rendering property transferred by the decedent during his lifetime includible in the gross estate and hence subject to the estate tax. The statutory phrasing chosen by Congress emphasized that the temporal relationship of these lifetime transfers to the death of the decedent was irrelevant; even property transferred many years before death could be included in the gross estate. There was no comparable reason for Congress to use the phrase in Section 641(b)(2) of DEFRA. Rather, the manifest purpose there was to emphasize that the subsection applied to estate tax returns filed at any time, even before the effective date of the statute.

course of action would cause the estate inevitably to lose a tax exemption that might otherwise have been available. Even if such an unlikely set of circumstances would come to pass, it is a complete mystery why Congress would want to address itself to such a situation and to eliminate the possible availability of a tax exemption for Project Notes only for an estate meeting these unusual criteria. Rather, the manifest purpose of Section 641(b)(2) was to operate retrospectively to prevent a rush to the courts by taxpayers who, having previously acted on the universally-held assumption that Project Notes were not exempt from the estate tax, might seek to secure a windfall by filing a refund suit based on *Haffner*.[10]

3. Appellees contend (Rosenberg Br. 25-36; Wells Fargo Br. 30-39) that Section 641(b)(2) of DEFRA violates

[10] Indeed, the Staff of the Joint Committee's explanation of the effective date provisions of Section 641 of DEFRA is unequivocal: "The provisions also apply to transfers occurring before June 19, 1984, if the transfers previously were reported as subject to Federal transfer tax. No claims for refund may be filed, therefore, with respect to such transfers." Staff of the Joint Comm. on Taxation, 98th Cong., 2d Sess., *General Explanation of the Revenue Provision of the Deficit Reduction Act of 1984*, at 972 (Joint Comm. Print 1984). Citing Treas. Reg. § 1.6661-3(b)(2), appellees maintain (Rosenberg Br. 10-11; Wells Fargo Br. 29 n.14) that the Joint Committee Staff report should be given no weight. While that regulation reflects the view that, for purposes of the substantial understatement penalty, the Joint Committee Staff report is regarded as less authoritative than pre-enactment legislative materials, it does not follow that the report should be ignored. This Court has cited reports of the Joint Committee Staff on other occasions (see *United States* v. *Ptasynski*, 462 U.S. 74, 77, 85 n.15 (1983); *United States* v. *Darusmont*, 449 U.S 292, 300 (1981)), and the report is particularly useful here where the statute in question was added to DEFRA at the last minute because of Congress's desire to respond quickly to the *Haffner* decision, thus leaving no opportunity to explain the provisions of Section 641 in the pre-enactment legislative materials. See also *Hutchinson* v. *Commissioner*, 765 F.2d 665, 669-670 (7th Cir. 1985); *Bank of Clearwater* v. *United States*, 7 Cl. Ct. 289, 294 (1985).

the Due Process Clause to the extent that it operates retroactively in requiring the inclusion in the gross estate of Project Notes reported on estate tax returns as taxable.[11] Appellees' arguments, however, are addressed to a hypothetical case that is quite different from this one. Appellees treat this case as identical to one in which Congress retroactively repealed a clearly established estate tax exemption—one on which it was reasonable to assume that many people acted in reliance. That is not this case, which involves a congressional effort to deal with the potential consequences of a court decision "discovering" a previously-unknown tax exemption in an old statute.

Responding immediately in DEFRA to the *Haffner* decision, it is clear that the 98th Congress believed two things: (1) there should not be an estate tax exemption for Project Notes; and (2) estates that had reported Project Notes as taxable on their returns had not acted on any expectation that there was such an exemption. Both of these beliefs were reasonable and, in our view, quite correct (see pages 15-16, *infra*). In these circumstances, Congress had two choices. It could have permitted these estates to file refund suits based on *Haffner* and thereby possibly obtain refunds based on an exemption that: (a) they never expected or acted in reliance upon; and (b) Congress thought was inappropriate. In other words, it could have permitted many estates to obtain a complete windfall. Or, alterna-

[11] Appellees also argue (Rosenberg Br. 22-25) that DEFRA violates due process because it unconstitutionally denies them judicial review. This contention is baseless. To be sure, DEFRA imposes a substantive rule regarding the taxability of Project Notes that will apply in a future refund suit; to that extent, it may doom an argument that a taxpayer otherwise could have advanced in such a suit. But DEFRA does not restrict access to the courts; indeed, this case itself is a refund suit filed by an estate that falls within Section 641(b)(2) of DEFRA—the type of case in which appellees suggest that the right of judicial review has been withdrawn. Thus, appellees' "judicial review" argument appears to be no more than their retroactivity argument in a different guise.

tively, Congress could have preserved the status quo as generally understood before *Haffner*, and as understood in particular by these taxpayers, of no estate tax exemption—an action that would not interfere one iota with any expectation of the taxpayers.[12] As explained in greater detail in our opening brief (at 38-44), the Due Process Clause did not prohibit Congress from choosing the latter course of action. Rather, this was "curative" legislation designed to limit the adverse effect of what Congress regarded as an erroneous judicial ruling, and it was well within Congress's constitutional authority.[13]

Appellees' efforts to distinguish this case from the numerous decisions that have upheld tax statutes with retroactive effect are unavailing. Appellees argue that a statute that eliminates an estate tax exemption for a particular type of property interferes with a taxpayer's planning in a way that a retroactive change in tax rates or elimination of an income tax exemption does not, and for that reason must be more difficult to sustain against a due

[12] Significantly, while appellees argue at length the theoretical possibility that an estate might have believed Project Notes to be tax-exempt and still have reported them as taxable in reliance on the right to seek a refund, they refrain from asserting that they themselves acted upon any expectation that Project Notes were exempt from estate taxation. The record belies any such claim (see U.S. Br. 45 n.23).

[13] Appellees appear to suggest (Wells Fargo Br. 33, 35-36) that DEFRA cannot be viewed as "curative" legislation if the *Haffner* decision is upheld because Congress in that case would not be trying to rehabilitate the original intent of the legislature. But that position means that there would be no such thing as "curative" legislation. If the courts reach the result that the present Congress believes to be correct, there is nothing to "cure"; it is only when the courts interpret existing law in a manner that Congress believes to be incorrect, as the *Haffner* courts did here, that it is necessary and appropriate for Congress to try to correct the courts' error through "curative" legislation. Thus, if the *Haffner* court's interpretation of the 1937 Act is ultimately upheld, that means only that DEFRA was necessary, not that it is unconstitutional.

process challenge (see Rosenberg Br. 27-28; Wells Fargo Br. 32 & n.17). The premise of this assertion is dubious. A taxpayer's planning can be upset by any of these types of retroactive legislation, and the alternatives that appellees suggest might have been employed here (had the decedent anticipated the enactment of DEFRA) are relevant in those contexts also (see Rosenberg Br. 28). Thus, just as in the case of removal of an estate tax exemption, an increase in the estate tax rate may make a taxpayer wish that he had " 'made gift transfers,' " and the elimination of an income tax exemption for a particular type of security may make a taxpayer wish that " 'he could have chosen investments with higher yields' " (*ibid.*, quoting *Netsky* v. *United States*, 652 F. Supp. at 786). The difference in altered expectations in the estate tax exemption context, therefore, is at most one of degree and does not call for a different constitutional analysis.[14]

4. As explained in our opening brief (at 44-48), there is no merit to the district court's conclusion that Section 641 of DEFRA violates the Equal Protection Clause by drawing an irrational distinction between different groups of taxpayers. Congress reasonably could have concluded that it was appropriate to limit the retroactive effect of DEFRA to estates that had treated the Project Notes as taxable on their return, in order to forestall a flood of re-

[14] The courts have consistently recognized that the general principle of upholding retroactive tax legislation unless it is "harsh and oppressive" is fully applicable in the estate tax context. See, *e.g.*, *Estate of Ekins* v. *Commissioner*, 797 F.2d 481 (7th Cir. 1986) (retroactive elimination of life insurance policies from class of property given in contemplation of death that can be excluded from gross estate); *Fein* v. *United States*, 730 F.2d 1211 (8th Cir.), cert. denied, 469 U.S. 858 (1984) (same); *Estate of Ceppi* v. *Commissioner*, 698 F.2d 17 (1st Cir.), cert. denied, 462 U.S. 1120 (1983) (retroactive elimination of exclusion from gross estate of first $3,000 of gifts made in contemplation of death).

fund suits by such estates seeking to gain a windfall from the *Haffner* decision, and at the same time allow estates whose returns suggested an intent to take the position that Project Notes were exempt from estate tax to proceed with their plan to litigate that issue in court. Appellees do not seriously dispute that it was rational for Congress to attempt to distinguish between estates that never thought that Project Notes were tax-exempt and estates that acted on the assumption that Project Notes were exempt from estate taxation; indeed, appellee Wells Fargo appears to concede (Br. 41-42 n.22) that such a distinction appropriately would preclude a "windfall" in a case where the decedent had "no expectation that [the Project Notes] would be exempt from estate taxation." Appellees do raise two objections, however, to the conclusion that the distinction drawn in DEFRA rationally advances that goal. These objections are not well taken.

Appellees object that the distinction drawn in DEFRA is irrational because "the position that an executor takes on a tax return has no *necessary* relationship to the executor's assumption as to taxability" (Wells Fargo Br. 41 (emphasis added)), *i.e.*, because of the availability of a refund suit, it was irrational for Congress to equate the *reporting* as taxable of Project Notes on a return as taxable with an *expectation* that the Notes were taxable (see Wells Fargo Br. 41-44; Rosenberg Br. 16-21). It is, of course, true that a taxpayer, relying on the availability of a refund suit, may choose to pay a tax that he does not believe is due. But it does not follow that Congress acted irrationally here. It is important to remember the background against which Congress acted in passing Section 641 of DEFRA. For almost half a century, there was no indication that anyone had ever acted on the supposition that Project Notes were exempt from estate taxation; indeed, the media reports cited by appellees (see Wells Fargo Br. 26) show that the

Haffner decision was universally heralded as the "discovery" of a new tax loophole.[15]

Thus, appellees' objection here—that Section 641(b)(2) includes estates that reported Project Notes as taxable, but nonetheless planned to file refund suits because they believed that the Notes were in fact tax-exempt—rests on little more than a *theoretical* possibility. This possibility could have occurred in actuality if other executors had been as prescient and imaginative as the Haffner executors, but, under the most generous of assumptions, only a minuscule number of the estates covered by Section 641(b)(2) could reasonably be thought to fall into this category. Congress surely did not act irrationally in failing to abandon its legislative scheme because of this theoretical possibility. The fact remains that the classification drawn by Congress in Section 641(b)(2) almost perfectly, if not absolutely perfectly, delineates a class of estates that acted upon the uniformly-held assumption that Project Notes were subject to estate taxation, and it was reasonable for Congress to decide that such estates should not reap a windfall from *Haffner*.[16]

Appellees' second objection (see Wells Fargo Br. 41 & n.22; Rosenberg Br. 16-18) is that reporting of Project

[15] Contrary to appellees' intimations (Wells Fargo Br. 34, 38; Rosenberg Br. 28), the circulars advertising Project Notes for sale did not give the investors any reason to suppose that Project Notes were exempt from estate taxation. The circulars do not suggest that the Notes are exempt from transfer taxes; they do no more than quote the language of Section 5(e) of the Housing Act of 1937 (see Appendix to Plaintiffs' Opposition to Defendant's Motion To Dismiss at 98).

[16] Appellees contend (Rosenberg Br. 18-21; Wells Fargo Br. 39-40) that several lower court cases hold that it necessarily violates the Equal Protection Clause to prohibit assertion of a claim in a refund suit that would be allowed if asserted directly on a tax return. These cases do not purport to establish such a broad rule and are totally inapposite here. First, none of these cases involved congressional action or a question of unconstitutionality. In each case the dispute centered on an administrative ruling establishing the contours of a change in position by the IRS; indeed, in one of the cases, the court found that the IRS's distinction was contrary to the intent of Congress clearly expressed in the legislative history (see *Ridgewell's, Inc.* v. *United States*, 655 F.2d 1098, 1102 (Ct. Cl. 1981)). More fundamentally,the nature of the distinctions drawn by the IRS in those cases was quite different from that drawn by Congress in DEFRA. In each case, the IRS was acting to eliminate a tax advantage that it had recognized in previous years and upon which there was every reason to believe many, if not most, affected taxpayers had relied. Thus, unlike here, in some of the cases cited by appellees it was quite clear that the distinction in the IRS's ruling could not have been justified on the ground that the initial payment of the tax evidenced the taxpayer's belief that the tax was owed. See *Ridgewell's, Inc.* v. *United States*, 655 F.2d at 1102 (taxpayer directed by the IRS agent to change its prior practice and begin to pay the tax); *Farmers' & Merchants' Bank* v. *United States*, 476 F.2d 406, 409 (4th Cir. 1973) (noting IRS approval and "prevalence" of practice later disallowed by IRS). In the other cases, in light of the previously-established IRS policy, the Claims Court simply determined that the IRS should not have implemented its change in policy by drawing a distinction that singled out the "occasional unfortunate who happened to pay his taxes" (*Connecticut Railway & Lighting Co.* v. *United States*, 142 F. Supp. 907, 909 (1956)). All of those cases are a far cry from this one where Congress acted to forestall a possible flood of refund suits that would seek to take advantage of a hitherto-unrecognized tax advantage that virtually all taxpayers did not anticipate when they filed their returns.

Notes on the estate tax return is relevant only to the expectations of the executor, not the decedent, and that the only expectations Congress rationally could have considered in DEFRA were those of the decedent. This objection is flawed in several respects. First, if the decedent is to be viewed as an entirely separate entity from the estate managed by his chosen executor, it must be noted that the entity affected by DEFRA is the estate, not the decedent. In other words, Congress simply—and quite reasonably—

made a determination about the tax liability of the estate based on the actions taken by the estate. Second, it is quite common in the law for an individual's rights to be affected by actions taken by his fiduciary, such as his attorney, and it is hardly unusual for the tax liabilities of the estate to be affected by the actions of the executor. For example, it is no defense to assessment of a penalty for late filing of an estate tax return to assert that the tardiness was the fault of the executor, not the decedent. See, *e.g., United States* v. *Boyle*, 469 U.S. 241 (1985). Finally, as a practical matter, it is highly unlikely that the hypothetical decedent who purchased Project Notes on the expectation that they would be exempt from estate taxation would have failed to communicate that expectation to his executor.

In sum, Congress acted quite rationally in using the reporting of Project Notes as taxable on an estate tax return as a means of identifying estates that might seek to reap a windfall from a refund suit based on *Haffner* even though they never had any expectation that Project Notes were exempt from estate taxation. At worst, the classification drawn by Congress is theoretically imperfect, but it is far from irrational.

For the foregoing reasons, and those stated in our opening brief, it is therefore respectfully submitted that the judgment of the district court should be reversed.

CHARLES FRIED
Solicitor General

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AMICUS CURIAE

BRIEF

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NO. 86-1521

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On Appeal from the United States District Court for the Central District of California

BRIEF FOR *AMICI CURIAE* THE ESTATE OF DOROTHY G. DILLON AND THE ESTATE OF VELMA C. GUBBELS IN SUPPORT OF APPELLEES

Of Counsel:
SHELLEY CASHION
CHAMBERLAIN, HRDLICKA,
WHITE, JOHNSON
& WILLIAMS
1400 Citicorp Center
1200 Smith Street
Houston, Texas 77002
(713) 658-1818

ROBERT I. WHITE
1400 Citicorp Center
1200 Smith Street
Houston, Texas 77002
(713) 658-1818
Counsel for Amici Curiae The Estate of Dorothy G. Dillon and The Estate of Velma C. Gubbels

Alpha Law Brief Co., Inc. — 8748 Westpark — Houston, Texas 77063 — 789-2000

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BRIEF FOR *AMICI CURIAE* THE ESTATE OF DOROTHY G. DILLON AND THE ESTATE OF VELMA C. GUBBELS IN SUPPORT OF APPELLEES

STATEMENT OF INTEREST OF *AMICI CURIAE*

Amici curiae are the Estates of Dorothy G. Dillon and Velma C. Gubbels. At their deaths on June 16, 1983 and

June 4, 1981, respectively, Mrs. Dillon and Mrs. Gubbels owned $2,469,640 and $225,000 in face value of obligations issued under Section 11(b) of the United States Housing Act of 1937, ch. 896, 50 Stat. 888 (1937) (codified as amended at 42 U.S.C. § 1437i(b) (1974)) ("Project Notes"). Mrs. Dillon's Project Notes were acquired prior to May, 1983, and Mrs. Gubbels' Project Notes were acquired from September 1980 through February 1981. After their deaths, their Estates filed estate tax returns on March 13, 1984, and March 4, 1982, both including the Project Notes as part of their gross estates. On June 27, 1984, the Dillon Estate, and on August 3, 1984, the Gubbels Estate, filed claims with the Internal Revenue Service for refund of the estate taxes attributable to the Project Notes, $1,177,853 plus interest (Dillon Estate) and $85,825.74 plus interest (Gubbels Estate).

The Gubbels Estate filed suit for refund in the United States District Court for the Southern District of Texas, Houston Division, Cause No. H-85-6714, and the Dillon Estate will file suit when the Internal Revenue Service disallows its amended claim for refund of estate taxes. Because the issues in Mrs. Gubbels' Estate's action are substantially the same as in this appeal, her Estate's action has been stayed pending the decision of this Court. Order of January 22, 1987 (Sterling, J.).

This brief *amici curiae* in support of Appellees is submitted with the consent of the parties, as provided in Rule 36.2, Rules of the Supreme Court of the United States.

SUMMARY OF ARGUMENT

I.

A. Section 5(e) of the United States Housing Act of 1937 ("Section 5(e)"), which has been relatively unchanged since its enactment, provides that both the "obligations" issued by public housing agencies and the "interest thereon" shall be exempt from "all taxation now or hereafter imposed by the United States." A plain reading of the phrase "all taxation" includes the federal estate tax. Moreover, ample extrinsic evidence exists to show that Congress intended that the Section 5(e) exemption apply to estate tax. First, other contemporaneously-enacted tax exemption statutes contained language that specifically excluded estate, inheritance, and/or gift taxes from an otherwise all-inclusive exemption. These contemporaneously-enacted statutes demonstrate that Congress used specific language when it intended to exclude the estate tax from a tax exemption clause. Second, in Section 5(e) Congress specifically distinguished "obligations" from the "interest thereon." Since Congress has never imposed a direct tax on personal property, the statutory reference to "obligations" would be meaningless except in the context of indirect taxes, such as estate and gift taxes.

B. The Government has denied the application of the Section 5(e) exemption for federal estate taxes on the basis of an arbitrary rule of statutory construction that emphasizes the formalistic but economically meaningless distinction between direct and indirect taxes. This Court recently has disapproved of this rule of statutory construction. Further, such an arbitrary distinction must fail in light of clear legislative intent to the contrary.

II.

A. Congress' statutory revocation, in 1984, of the Section 5(e) exemption from federal estate tax, offends traditional notions of due process. First, due process demands that the Government deal fairly with its citizens. As to any Project Notes issued and purchased prior to enactment of the 1984 statute, the Government has not lived up to its side of the bargain by revoking a promised exemption before the benefit of that exemption could be realized. Such revocation at least adversely affects the value of the Notes. Second, as to any Project Notes that were transferred prior to the 1984 statute, by death or gift, the 1984 statute reverses the exemption in some but not all situations. The combined effect of the denial of governmentally-induced expectations and the reversal of law applicable to a previously-consummated transaction is a clear violation of Appellees' due process rights.

B. The 1984 statutory revocation of the Section 5(e) exemption for estate tax also violates the equal protection clause of the Fifth Amendment. It purports to single out for denial of the exemption only those estates which did not claim the exemption on an estate tax return. The creation of, and discrimination against, this special class of estates rests upon an arbitrary irrebuttable presumption that the estate's reporting position on the estate tax return accurately reflected the expectations that the decedent had with regard to his Project Notes. Because the classification created by the 1984 statute is arbitrary and has no rational relationship to its purpose, it violates Appellees' equal protection rights.

ARGUMENT

I. SECTION 5(e) OF THE HOUSING ACT OF 1937 PROHIBITS THE IMPOSITION OF ESTATE TAX ON PROJECT NOTES

A. Conclusive Evidence of Legislative Intent—the Lodestar for Application of any Federal Statute—at the Enactment of Section 5(e) Proves That Congress Affirmatively Meant to Exempt Project Notes From Estate Taxes.

In the interpretation of a federal statute, the function of the courts is to construe the language of the statute so as to give effect to the intent of Congress. *United States v. American Trucking Ass'ns*, 310 U.S. 534, 542 (1940) ("To find [the statutory words'] content, they must be viewed in their setting"). *Accord, Philbrook v. Glodgett*, 421 U.S. 707, 713 (1975). Indeed, ascertaining and giving effect to the intent of Congress is the courts' "first duty" when applying a statute. *Solis-Ramirez v. United States Dep't of Justice*, 758 F.2d 1426, 1431 (11th Cir. 1985); *Richmond Welfare Rights Org. v. Snodgrass*, 525 F.2d 197, 202 (9th Cir. 1975).

In fulfilling this duty to determine the intent of Congress, courts must look first to the literal meaning of the words employed in the statute, *Flora v. United States*, 357 U.S. 63, 65 (1958), and assume "that Congress said what it meant and meant what it said." *Pettis ex rel. United States v. Morrison-Knudsen Co.*, 577 F.2d 668, 672 (9th Cir. 1978). Thus, when Congress provided in Section 5(e) of the Housing Act of 1937 that Project Notes "shall be exempt from all taxation now or hereafter imposed by the United States," the conclusion must be that Congress meant precisely "all taxation," including

estate tax. *See American Bank & Trust Co. v. Dallas County*, 463 U.S. 855, 862 (1983) ("Absent a clearly expressed legislative intention to the contrary, [the statutory] language must ordinarily be regarded as conclusive," *citing Consumer Prod. Safety Comm'n v. GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980)).

Moreover, in addition to the plain meaning of Section 5(e)'s language, there is overwhelming extrinsic evidence that Congress intended the Section 5(e) exemption to embrace estate taxes. This evidence is described at length in *Haffner v. United States*, 585 F. Supp. 354 (N.D. Ill. 1984), *aff'd as modified*, 757 F.2d 920 (7th Cir. 1985), and will not be repeated here.

Such intent also appears in the broader context of other tax exempt obligations authorized by Congress at or near the same time that it enacted the Housing Act of 1937. Many of these contemporaneous statutes, like Section 5(e), provided for a universal exemption from all taxation.[1] Others, unlike Section 5(e), excluded, always by specific parenthetical reference, various taxes from the otherwise universal exemption.[2]

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1. For example, in the Fourth Liberty Bond Act, ch. 142, § 3, 40 Stat. 844, 845 (1918), as amended by Section 4 of the Victory Liberty Loan Act, ch. 100, 40 Stat. 1309, 1311 (1918), Congress chose to exempt obligations described therein from all taxes using the language "* * * be exempt both as to principal and interest from any and all taxation * * *". This universal exemption included estate and inheritance taxes, as held in *Jandorf's Estate v. Commissioner*, 171 F.2d 464 (2d Cir. 1948).

2. In the following statutes, Congress excluded only estate and inheritance taxes: First Liberty Bond Act, ch. 4, § 1, 40 Stat. 35 (1917); Federal Deposit Insurance Corporation Act, ch. 89, § 8, 48 Stat. 162, 168 (1933); *cf.* 31 U.S.C. § 3124 (excludes nondiscriminating franchise taxes along with *state* estate and inheritance taxes from the exemption for federal obligations from state tax).

Typical of the language Congress used is (i) "(except surtaxes, estate, inheritance, and gift taxes)," *e.g.*, Reconstruction Finance Corporation Act, ch. 8, § 10, 47 Stat. 5, 9 (1932); Federal Home Loan Bank Act, ch. 522, § 13, 47 Stat. 725, 735 (1932); Federal Farm Mortgage Corporation Act, ch. 7, § 12(b), 48 Stat. 344, 347 (1934); Section 20(b) of the United States Housing Act of 1937, ch. 896, 50 Stat. 888, 898 (1937); and (ii) "except (a) estate or inheritance taxes, and (b) surtaxes, excess profits and war-profits taxes," *e.g.*, Second Liberty Bond Act, ch. 56, § 7, 40 Stat. 288, 291 (1917); Section 16 of the War Finance Corporation Act, creating the War Finance Corporation, ch. 45, 40 Stat. 506, 511 (1918) ("except (a) estate or inheritance taxes, and (b) graduated additional income taxes, commonly known as surtaxes").

Obviously, Congress thought that it was accomplishing something when it carefully selected some or all of the estate, inheritance, and gift taxes to exclude from tax exemptions for these pre-World War II obligations. This underscores the vitality of the common-sense rule of statutory construction that statutes should not be construed to render any provision surplusage and that every word used by Congress should be given effect. *E.g., In re Co Petro Mktg. Group, Inc.*, 680 F.2d 566, 569-570 (9th Cir. 1982). Contrary to this rule, the Government's position would render as surplusage all references to estate, inheritance, and gift taxes in these pre-World War II statutes. This is an untenable interpretation of congressional intent.[3]

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3. The *Haffner* court considered the language of Section 20(b) of the Housing Act of 1937, a companion section to Section 5(e), to show an intention that the tax exemption for Project Notes included an estate tax exemption. Section 20(b) exempted certain obligations from "all taxation (except surtaxes, estate, inheritance, and gift taxes)." *Haffner*, 585 F. Supp. at 357-359.

The Government advances the unsupported theory that Congress carved out estate and gift taxes, after first having carved out surtaxes, from Section 20(b) to forestall an *expressio unis est exclusio alterius* argument with respect to that section. Government's Brief, at 28-29. The Government thereby attempts to diffuse the lack of such limitation on Section 5(e)'s exemption. The Government's argument fails to account for the statutes described above that excluded estate and inheritance taxes but not surtaxes, *e.g.*, Section 1 of the First Liberty Bond Act, *supra* n.2, or those that clearly treat estate and inheritance taxes as a class of excluded taxes separate

Additional evidence of congressional intent to exempt Project Notes from estate and other indirect taxes is the clear distinction Congress made in Section 5(e) between taxation of the obligations themselves and the "interest thereon." Section 5(e) expressly exempted from all taxation the obligations themselves and the interest thereon "now or hereafter imposed *by the United States.*" *Id.* (emphasis added). It cannot be doubted that the exemption for interest refers to the federal income tax on interest. But as to the obligations themselves, there was neither then, nor has there been since then, *any* tax imposed by the United States upon such obligations, other than those indirect taxes, like the federal estate and gift taxes (extant in 1937), that are measured by the value of the obligations. Except to exempt the obligations from estate and gift taxes, what would be the reason for the exemption as to the obligations themselves?

The taxes authorized by the United States Constitution fall into two categories: (1) *direct* taxes, which are either income taxes authorized by the Sixteenth Amendment to be imposed without apportionment, or other direct taxes which may be imposed only with apportionment among the states based on population, or (2) *indirect* taxes (*i.e.*, "duties, imports, and excises"), which, although subject to the requirement that they be "uniform throughout the United States," are not subject to the apportionment rule. U.S. Const. art. I, § 8, cl. 1; art. I, § 2, cl. 3; art. I, § 9, cl. 4; amend. XVI; *see generally Flint v. Stone Tracy Co.*,

and apart from graduated income taxes, *e.g.*, Section 7 of the Second Liberty Bond Act, *supra* n.2 ("except (a) estate or inheritance taxes, and (b) * * * surtaxes, and excess profits, and war-profits taxes"). Congress' meticulous attention toward the inclusion or exclusion of these indirect taxes from an otherwise universal exemption demands the conclusion that Congress intended that Section 5(e)'s exemption apply to all taxes computed by reference to the Project Notes.

220 U.S. 107 (1911). Thus, the only taxes that Congress could have contemplated as applying to the obligations, as distinct from the interest paid thereon, were either direct taxes subject to the apportionment rule[4] or indirect taxes measured by reference to the principal or current value of the obligations. Unless in 1937 Congress contemplated that it might do what it had never done, and since then has never done—impose an apportioned direct tax on personal property[5]—the conclusion is inescapable that Congress meant the Section 5(e) exemption to preclude the imposition of indirect taxes such as estate, inheritance and gift taxes.[6]

4. The principal of each obligation is, of course, not taxable as income. *See, e.g., Southern Pacific Co. v. Lowe*, 247 U.S. 330 (1918).

5. As explained in Justice Harlan's dissent in *Pollock v. Farmers' Loan & Trust Co.*, 158 U.S. 601, 649 and 660 (1895), the last time that Congress attempted to impose a "direct tax" was in 1861 (Act of Aug. 5, 1861, ch. 45, § 13, 12 Stat. 294, 297), and neither this nor the four previous direct taxes (in 1798, 1813, 1815, and 1816) were applicable to any property except real estate and slaves. *See generally* Morrow, "The Income Tax Amendment," 10 *Columbia L. Rev.* 379 (1910).

6. Congress again used the distinction between obligations and the interest on the same obligations in 31 U.S.C. Section 3124, discussed *infra* at 11, a statute that clearly covers both direct and indirect taxes.

The Government, implying that exemption from estate taxes could never have been Congress' intention in enacting Section 5(e), states (Government's Brief, at 12, 21) that if Section 5(e) exempts Project Notes from estate tax, taxpayers could avoid all estate taxes by converting their assets into Project Notes. Such statement does not at all deal with congressional intent in 1937, which was to promote, through tax exemptions, the sale of Project Notes. To illustrate the Government's leap in logic, all taxpayers can avoid income tax altogether on investment income by purchasing income tax exempt bonds; that result, however, cannot be said to deal with Congress' purpose in enacting that income tax exemption.

B. The Rule of Statutory Construction Advanced by the Government, That Universal Exemptions From Taxation Do Not Include Indirect Taxes Such as the Estate Tax, Has Been Abandoned by This Court in an Analogous Context.

In applying Section 5(e) of the Housing Act, the Government has not sought to determine and implement congressional intent. Instead, the Government seeks to supplant congressional intent with a rule of statutory construction based on the distinction between direct taxes and indirect taxes. Government's Brief, at 18-20. This rule of construction provides that an exemption that refers to property does not apply to indirect taxes, such as the estate tax, unless it specifically mentions transfers of that property. Congressional intent would play no part in this rule.

Like the rule itself, the distinction between direct and indirect taxes has no basis in legislative intent. Rather, it is borrowed from the constitutional distinction between direct and indirect taxes for purposes of the apportionment rule. U.S. Const. art. I, § 9, cl. 4.[7] In the context

7. Thus, in *Plummer v. Coler*, 178 U.S. 115 (1900) (superseded by statute as stated in *American Bank & Trust Co. v. Dallas County*, 463 U.S. 855 (1983)), the Court's decision that a state could impose an inheritance tax on federal obligations was based not on an understanding of congressional intent but on the ground that the tax was an extension of the state's right to regulate the descent of property. *See also Murdock v. Ward*, 178 U.S. 139, 147-148 (1900) ("[I]f, as held in *Knowlton v. Moore*, [178 U.S. 41 (1900)], the tax imposed under the act of June 13, 1898 [federal inheritance tax], is *not invalid as a direct, unapportioned tax*, nor for want of uniformity, nor as an infringement upon the laws of the states regulating wills and descents, then the [federal] tax upon legacies or bequests, descendible under and regulated by state laws, is valid, even if such legacies incidentally are composed of Federal bonds" (emphasis added)); *New York Trust Co. v. Eisner*, 256 U.S. 345, 348 (1921) *citing Knowlton v. Moore*, *supra*, for the proposition that the federal estate tax was not an unconstitutional interference with thte states' right to regulate descent and distribution. Like *Plummer*, both *Murdock* and *New York Trust* dealt with the validity of a taxing statute under constitutional principles, not with an exemption statute or Congress' intent in enacting an exemption statute.

The origin of the direct versus indirect tax distinction had little to do with tax exempt obligations. As explained by Justice Paterson in *Hylton v. United States*, 3 Dall. 171, 177 (1796), the constitutional distinction between the two kinds of taxes and the direct tax apportionment rule "was made in favor of the Southern states. They possessed a large number of slaves. They had extensive tracts of territory, thinly settled, and not very productive. • • • The Southern states • • • would have been wholly at the mercy of the other states. Congress, in such case, might tax slaves, at discretion or arbitrarily, and land in every part of the Union after the same rate or measure • • • ".

of tax exemption statutes, the distinction between direct and indirect taxes recently has been characterized by this Court as a "formal but economically meaningless distinction." *American Bank & Trust Co. v. Dallas County*, 463 U.S. 855, 858 (1983). The distinction thus carries little weight in the face of the equally well-settled rule that effectuation of legislative intent is the primary goal of a court when construing a statute.

In *American Bank & Trust Co.*, this Court interpreted 31 U.S.C. Section 3124, which exempts stocks and obligations of the United States Government from most forms of state and local taxation. Prior to 1959, the statute provided, in pertinent part, that all such stocks and obligations "shall be exempt from taxation by or under State or municipal or local authority." In 1959, the statute was amended[8] by adding the following sentence (set forth below with further, non-substantive language changes made in 1982) (31 U.S.C. § 3124(a)):[9]

8. Pub. L. 86-346, § 105(a), 73 Stat. 621, 622 (1959).

9. Pub. L. 97-258, 96 Stat. 877, 945 (1982).

> The exemption applies to each form of taxation that would require the obligation, the interest on the obligation, or both, to be considered in computing a tax, except— * * *
>
> (2) an estate or inheritance tax.

"Congress intended [by the 1959 amendment] *to sweep away formal distinctions* and to invalidate all taxes measured *directly or indirectly by the value* of federal obligations, *except those specified in the amendment.*" *American Bank & Trust Co.*, 463 U.S. at 867 (emphasis added). Although Congress specifically excluded state estate and inheritance taxes (but, notably, not gift taxes) from the exemption, Congress also made clear its intention that when it exempts an obligation from tax, then, except for expressly stated exceptions, all taxation is prohibited "regardless of its *form* if federal obligations must be considered, either directly or indirectly, in *computing* the tax." *Id.* at 862 (emphasis in the original).

Although the *American Bank & Trust Co.* case addressed a state law imposing a property tax on bank shares valued by reference to bank assets, which could include United States obligations, the Court's reasoning in disregarding the direct-versus-indirect tax distinction for exemption purposes applies equally to estate taxes. As this Court explained, "just as state tax laws relating to corporate or bank shares generally assess the shares according to the value of the corporation's assets, * * * estate and inheritance taxes customarily assess * * * the demise [of the decedent] at the value of * * * the property inherited." *Id.* at 863. Referring more specifically to the direct-versus-indirect tax distinction, the Court stated (*Id.* at 858):

> Similarly, the Court interpreted Rev.Stat. § 3701 [the predecessor to 31 U.S.C. Section 3124] not to prohibit taxes imposed on a discrete transaction, *such as an inheritance*, even though the value of the inheritance was measured according to the value of the federal obligations transferred. *Plummer v. Coler*, 178 U.S. 115, 133-134 (1900) * * *. In 1956 [sic, 1955], the Court observed that this *formal but economically meaningless distinction* between taxes on Government obligations and taxes on separate interests was "firmly embedded in the law." *Society for Savings v. Bowers*, 349 U.S., at 148, 75 S. Ct., at 610. (Emphasis added.)

Thus, since as early as 1955, this Court has acknowledged that the distinction asserted by the Government, at least in the context of exempt obligations, was a formalistic and substantively groundless distinction.[10] Transplanted from an arcane area of constitutional law, the method urged by the Government of interpreting an exemption by distinguishing between direct and indirect taxes, has never been grounded in any evidence of legislative intent. Now, at least with respect to the exemption for federal obligations from state taxes, the distinction has been entirely repudiated. Unless such a formalistic rule is to prevail over the clear wording of Section 5(e) and strong evidence of legislative intent, and unless meticulous congressional attention to the inclusion and exclusion of estate, inheritance, and gift taxes in early exemption statutes is to be disregarded as multiple exercises in fu-

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10. One need only review this Court's decision in *Pollock v. Farmers' Loan & Trust Co.*, 158 U.S. 601 (1895), to appreciate the great difficulty that Congress has always had in attempting to distinguish direct from indirect taxes and the lack of any inherent conceptual difference between the two kinds of taxes. Referring to the constitutional apportionment rule, Alexander Hamilton stated: "What is the distinction between *direct* and *indirect* taxes? It is a matter of regret that terms so uncertain and vague in so important a point [the apportionment rule] are to be found in the Constitution." VIII *Works of Hamilton* 389 (Fed. ed.).

tility, the Government cannot prevail.[11] Any genuine interpretation of Section 5(e) leads to the conclusion that in exempting the Project Notes and the interest thereon from "all taxation," Congress exempted the Notes from gift and estate taxes and the interest from income taxes.

II. TO THE EXTENT THAT SECTION 641 OF THE DEFICIT REDUCTION ACT OF 1984 PURPORTS TO REVOKE SECTION 5(e)'s EXEMPTION FROM FEDERAL ESTATE TAX ON PROJECT NOTES PURCHASED OR TRANSFERRED PRIOR TO SECTION 641's ENACTMENT, SECTION 641 VIOLATES BOTH THE DUE PROCESS CLAUSE AND THE EQUAL PROTECTION CLAUSE OF THE FIFTH AMENDMENT

A. Section 641 Violates the Due Process Clause of the Fifth Amendment by Purporting to Revoke a Tax Exemption for Project Notes Purchased or Transferred Prior to the Enactment of Section 641.

In Section 5(e) of the Housing Act of 1937, to encourage the purchase of Project Notes, Congress guaranteed that purchasers of those Notes would not have to pay federal tax on either the obligations themselves or on the interest generated by those obligations. Forty-seven years later, in legislation tailored to reduce the federal budget deficit, Congress purported to revoke a portion

11. To the extent that the Government relies on Section 641 of Deficit Reduction Act of 1984, Pub. L. 98-369, 98 Stat. 494, 939 (1984), as evidence of congressional intent with respect to Section 5(e), this Court has often stated that "the views of a subsequent Congress form a hazardous basis for inferring the intent of an earlier one." *Consumer Prod. Safety Comm'n v. GTE Sylvania, Inc.*, 447 U.S. 102, 117-118 (1980).

of that exemption, not only with regard to Project Notes yet to be issued, but also as to Project Notes already outstanding. Section 641 of the Deficit Reduction Act of 1984, Pub. L. 98-369, 98 Stat. 494, 939 (1984) ("Section 641"). The guaranty of due process of law under the Fifth Amendment to the United States Constitution cannot tolerate such retroactivity. U.S. Const. amend. V.

Section 641's due process infirmities are two-fold. First, it applies to any Project Notes issued before 1984, even if the Project Noteholder died prior to 1984.[12] Section 641 thus purports to retroactively deprive the purchaser of the benefit of his bargain, a benefit which was specifically enacted by Congress to induce the purchase of the obligations. Second, the executors of estates of decedents, who died prior to 1984 owning Project Notes, may have been misled by the announcement of the Internal Revenue Service, first published in 1981, that it took the position that Project Notes were not exempt from estate tax. Rev. Rul. 81-63, 1981-1 C.B. 455. Due to the executor's personal liability to ensure that all estate taxes were paid prior to distributing the estate, 26 U.S.C. § 2002 and 31 U.S.C. § 3713(b), or the fiduciary's desire to forcelose that potential liability, 26 U.S.C. § 2204(a), the executor may simply have concluded that the Project Notes should be included in the estate tax return, without regard to the decedent's original expectations, reserving the resolution of the Project Note issue to a suit for refund of taxes erroneously paid. In this event, Section 641 purports to reach back to the time at which the applicable law should have been con-

12. Section 641(b)(2) makes Project Notes taxable "if at any time there was filed an estate or gift tax return showing such transfer as subject to Federal estate or gift tax."

clusively determined—the Project Noteholder's death—and supplant the then-applicable law with a different and adverse law. In its zeal to collect additional revenues, Congress thus has disregarded fundamental principles of legal certainty and of fairness to purchasers of the tax-exempt Project Notes.[13]

Similarly, in determining whether Project Noteholders had knowledge of the Internal Revenue Service's 1981 statement of intention to deny exemption, or relied on the exemption in deciding to buy the Project Notes, Section 641 treats the wrong event—the after-the-fact reporting of the Project Notes on an estate tax return—as determinative. Instead, notice and reliance should be viewed on the date of purchase of the obligations, the transaction induced by the exemption. By the time the estate tax return is filed, the inducement by, and the reliance on, the exemption has already occurred. Unless the exemption is preserved until the otherwise taxable event—at least the death of all Project Noteholders who died prior to the July 18, 1984 legislation—the Noteholder will have suffered an inequity that amounts to a deprivation of due process rights. *Cf. United States v.*

13. Contrary to the Government's characterization of the issues here, the exemption claimed by the estates of Project Noteholders is not based on the *Haffner* decision but, rather, on Section 5(e) of the Housing Act of 1937 and its successors. *Haffner* merely reaffirmed that exemption and repudiated the position of the Internal Revenue Service in its 1981 revenue ruling.

The Government states that the *Haffner* case is the first instance in 40 years of a taxpayer seeking exemption of the Project Notes under Section 5(e) from estate tax. Government's Brief, at 12. What was the basis for such statement? It is more likely that executors have always omitted Project Notes from the list of taxable assets in estate tax returns, just as taxpayers would always omit the interest on Project Notes from income tax returns they filed. In this light, the abrasiveness of the 1984 legislation comes into sharper focus.

Darusmont, 449 U.S. 292, 299 (1981) (advance notice of an increase in tax rate vitiates any due process concerns).[14]

Thus, the fact that the taxpayer could have altered his behavior to avoid the tax, if he had anticipated it at the time of the transaction, was found dispositive on constitutional challenges to gift taxation in *Blodgett v. Holden*, 275 U.S. 142, 147 (1927), *modified*, 276 U.S. 594 (1928) ("It seems wholly unreasonable that one who, in entire good faith and without the slightest premonition of such consequence, made absolute disposition of his property by gifts should thereafter be required to pay

14. The Internal Revenue Service itself has recognized the unfairness that results if a tax provision designed to induce certain activity is revoked with no exception for taxpayers who had already engaged in the desired activity. In 1969, then Assistant Secretary of the Treasury for Tax Policy Edwin S. Cohen wrote:

> [P]rovisions have been deliberately kept in the tax law over many years, and they constitute standing invitations for taxpayers to erect new buildings, drill for oil, or embark on programs of charitable contributions. Even if we should conclude that it would be unwise to continue some of these benefits or if we should alter some of them, it would not be appropriate to remove the preference precipitously after taxpayers have embarked on programs which they might not have adopted except for these provisions.

Cohen, *Administration's Interim Program of Tax Reform and Tax Relief, reprinted in* 47 *Taxes* 325, 327 (1969). Similarly, the Treasury Department has stated:

> In general, the repeal of code provisions that provide an incentive for certain business-related expenditures or investments in specific assets should be developed to minimize the losses to persons who made such expenditures or investments prior to the effective date of the new law. The principal technique to effectuate this policy would be to grandfather actions under current law.

U.S. Dept. of the Treasury, *Blueprints for Basic Tax Reform* 200 (1977).

Notwithstanding this recognized unfairness, in Section 641 Congress not only failed to "grandfather" Project Notes issued prior to and still held in 1984, but it also sought to extend the revocation of the exemption to Noteholders who had died, and thereby transferred their obligations by death, long before the enactment of Section 641.

a charge for so doing"); *Untermyer v. Anderson*, 276 U.S. 440, 445 (1928); and *Nichols v. Coolidge*, 274 U.S. 531, 543 (1927);[15] *United States v. Hemme*, 476 U.S. 558 (1986) (the court must examine whether, without notice, a statute gives a more oppressive legal effect to conduct undertaken before enactment of the statute).

Finally, the Government attempts to analogize the case at bar to court decisions permitting the retroactive application of Section 2662(g) of the Deficit Reduction Act of 1984. Government's Brief at 43.[16] However, un-

15. Later cases, relied upon by the Government herein, have narrowed the holding of *Untermyer* to distinguish between a new tax and a rate change in an existing tax. *Milliken v. United States*, 283 U.S. 15 (1931) (existence of gift tax itself was not at issue, only the retroactivity of the rate); *Westwick v. Commissioner*, 636 F.2d 291, 292 (10th Cir. 1980) (limiting *Untermyer* to "wholly new types of taxes"); *Buttke v. Commissioner*, 625 F.2d 202, 203 (8th Cir. 1980), *cert. denied*, 450 U.S. 982 (1981) (*Untermyer* read to hold that "retroactive application of wholly new tax invalid"); *Estate of Ceppi v. Commissioner*, 698 F.2d 17, 21 (1st Cir.), *cert. denied*, 462 U.S. 1120 (1983).

In contrast, Section 641 applies to obligations that may well never have been purchased *but for* the Section 5(e) exemption. The tax-exempt nature of the Project Notes was and is their primary selling point, as illustrated by the description of the modern versions of Project Notes in circulars issued by the Department of Housing and Urban Development; they are described as "Short-Term Tax-Exempt Project Notes." HUD Circular, Form GPO 872 983.

Section 641, however, purports to apply to deaths occurring prior to its enactment. Thus, unlike any other precedents, Section 641 not only reverses the tax consequences as *expected* by the Project Noteholder and *promised* by the United States Government at the time of the underlying transaction (the purchase and holding of the Project Notes), but also reverses the law as actually *effective* on the date of the tax-determining event, the death of the Project Noteholder.

16. *New England Baptist Hosp. v. United States*, 807 F.2d 280 (1st Cir. 1986); *Canisius College v. United States*, 799 F.2d 18 (2d Cir. 1986), *cert. denied*, ____U.S.____, 107 S. Ct. 1887 (1987); and *Temple Univ. v. United States*, 769 F.2d 126 (3d Cir. 1985), *cert. denied*, ____U.S.____, 106 S. Ct. 2914 (1986).

like the concise exemption in Section 5(e) that was widely advertised to the bond-buying public, the cases cited by the Government interpreting Section 2662(g) dealt with the highly-technical area of employee retirement annuity plans and with the incidental issue of whether salary reduction amounts paid into retirement plans designed to qualify for the income tax exemption of 26 U.S.C. Section 403(b) should likewise be excluded from social security withholding under 26 U.S.C. Section 3121(a). Section 2662(g) retroactively denied the social security exclusion, and the courts upheld Section 2662(g) primarily on the basis that it merely codified Rev. Rul. 65-208, 1965-2 C.B. 383, issued nineteen years before Section 2662(g) was enacted and fifteen to seventeen years earlier than the salary reductions and payments made in the cases cited by the Government.

In contrast, the first pronouncement by the Internal Revenue Service specifically addressing the Section 5(e) exemption, Rev. Rul. 81-63, 1981-1 C.B. 455, was published on February 26, 1981, *after* the purchase of Project Notes by Mrs. Gubbels, one of the decedents represented by counsel for *amici curiae*. Even if the reporting of the Project Notes in her estate tax return by the executor may have been prompted by the 1981 Revenue Ruling, by that time the inducement by and reliance on the Section 5(e) exemption had already occurred.

For forty-seven years prior to 1984, Section 5(e) and its successors offered an exemption "from all taxation" on Project Notes themselves and the interest paid on such Notes. The exemption was specifically intended and promoted to induce the purchase of the Project Notes in order to finance the achievement of a worthwhile social

goal. To retroactively revoke that exemption after the purchase had been consummated would be tantamount to a breach of a contract between the Government and its citizens (certainly the Notes themselves declined in value), a breach aggravated by the fact that the revocation applies to situations in which the Government's side of the bargain had already accrued, *i.e.*, when the Project Noteholder had already died. No budgetary rationalization by the Government can justify such a violation of due process guarantees of fairness.

B. The Retroactive Imposition of Taxes and the Elimination of Appellees' Rights to Pursue a Suit for Refund Violate the Equal Protection Clause.

The equal protection clause of the Fifth Amendment also renders the retroactive effect of Section 641 invalid. Traditionally, statutory classifications in tax cases must be rationally related to a legitimate governmental purpose. *Williams v. Vermont*, 472 U.S. 14, 21 (1985); *Regan v. Taxation with Representation*, 461 U.S. 540, 547 (1983). Even under this minimal standard of scrutiny, the classification scheme in Section 641 of the Act fails because it does not rationally advance any reasonable and justifiable governmental objective.[17] *Logan v. Zimmerman*

17. The minimal standard is not "toothless": it requires the presence of a legitimate governmental objective. *Schweiker v. Wilson*, 450 U.S. 221, 234-235 (1981) ("As long as the classificatory scheme chosen by Congress rationally advances a reasonable and identifiable governmental objective, we must disregard the existence of other methods of allocation that we, as individuals, perhaps would have preferred"); *Mathews v. Lucas*, 427 U.S. 495, 510 (1976); *Dandridge v. Williams*, 397 U.S. 471, 485 (1970) ("If the classification has some 'reasonable basis,' it does not offend the Constitution simply because the classification 'is not made with the mathematical nicety or because in practice it results in some inequality' ").

Brush Co., 455 U.S. 422, 439 (1982) (Blackmun, J., concurring); *see McGowan v. Maryland*, 366 U.S. 420, 426 (1961) ("statutory discrimination will not be set aside if any state of facts reasonably may be conceived to justify it").

Section 641 separates virtually identical taxpayers, and then, through its retroactive provision, accords them disparate treatment. It is immediately apparent from reading Section 641(b) that artificial categories of similarly situated taxpayers are treated differently by the statute, resulting in taxation of some Project Notes but freeing other Project Notes from the estate tax. This can be illustrated as follows:

TAXPAYER	PROJECT NOTES SUBJECT TO TAX?
Decedents dying before June 19, 1984, whose Project Notes were reported as taxable on their estate tax returns.	Yes: reporting the Notes on the estate tax return and paying the tax, according to Section 641(b)(2), would sweep the taxpayer into Section 641(a), which renders the Notes taxable.
Decedents dying before June 19, 1984, whose Project Notes were not listed on their estate tax returns.	No: Section 641(b)(3) provides that no inference should be drawn from Section 641 that pre-effective date transfers of Project Notes are not subject to estate tax. Thus, all decedents' estates which omitted the Project Notes from their estate tax returns are governed by the then-existing law, as interpreted by the courts.
Decedents dying before June 19, 1984, who fail to file estate tax returns.	No; having not including the Notes in an estate tax return, the preceding rule applies.

The distinction, the reporting as taxable or non-reporting of Project Notes on an estate tax return, has no legitimate purpose. The only purpose conceivable for this distinction is to prevent taxpayers from changing their

legal position in the wake of *Haffner v. United States*.[18] As in *Reed v. Reed*, 404 U.S. 71, 76 (1971), giving preference to a discrete class "merely to accomplish the elimination of hearings on the merits, is to make the very kind of arbitrary legislative choice forbidden by the Equal Protection Clause." The stated congressional purpose, lessening the rush to the courthouse in the wake of *Haffner*, is not legitimate.[19] The illegal holding of these taxpayers' property raises money, but the protection of the public fisc must be achieved by constitutional means.[20] As stated in *McLaughlin v. Florida*, 379 U.S. 184, 194 (1964):

> When the law lays an unequal hand on those who have committed intrinsically the same quality of offense and sterilizes one and not the other, it has made as an invidious a discrimination as if it had selected a particular race or nationality for oppressive treatment.

18. Indeed, the General Explanation prepared by the Staff of the Joint Committee on Taxation for Section 641 makes it clear that this was precisely the objective of Section 641. *General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984*, H.R. 4170, 2d Sess., 98th Cong. (Dec. 31, 1984), *reprinted in* "Tax Reform Act of 1984, General Explanation of the Revenue Provisions," CCH Standard Federal Tax Reports, No. 3, at 971 (Jan. 12, 1985).

19. *Compare* Section 641 here *with* the statute in controversy in *Temple Univ. v. United States*, 769 F.2d 126, 134 (3d Cir. 1985), *cert. denied*, ___U.S.___, 106 S. Ct. 2914 (1986), in which the court justified the disparate treatment by stating that "the legislative history of the 1984 Act expressly disclaims any intent to validate failures to withhold F.I.C.A. taxes."

20. The Court of Claims suggested in *Hospital Data Center, Inc. v. United States*, 634 F.2d 541, 544 n.11 (1980), that an equal protection challenge could be made to a 1976 statute that retroactively forced voluntary payors of social security tax to forfeit their refunds. The plaintiff-corporation in *Hospital Data* inadvertently paid tax for which it was not liable and was unable to obtain a refund for such taxes due to intervening legislation that retroactively rendered the plaintiff liable for such taxes.

It is no justification, (as was asserted in *Temple Univ. v. United States*, 769 F.2d 126, 134 (3d Cir. 1985), *cert. denied*, ___U.S.___, 106 S. Ct. 2914 (1986)), that the Government may succeed in ultimately collecting estate tax on the Notes from taxpayers who either did not list the Notes in an estate tax return or did not file such return. Such taxpayers' Notes are not subjected to the automatic tax of the new legislation. Additionally, such taxpayers may still have their day in court, that right being unaffected by Section 641. The ultimate effect of Section 641 is to exclude Appellees from suing for a refund of estate taxes on the Project Notes, while other similarly situated taxpayers have the opportunity to challenge the estate tax on those same Notes.[21]

Tax refund claims, by statute, can be filed upon payment of the tax, without being made under protest or duress, provided that suit for refund is filed within the applicable statute of limitations. 26 U.S.C. §§ 7422(b), 6532(a). Payment of the tax is no more than a jurisdictional prerequisite to filing a tax refund suit. *Flora v. United States*, 357 U.S. 63, 64-65 (1958). Thus, the purpose evident in the legislative history of Section 641, that of shielding the Treasury from a drain of tax dollars from *Haffner* refund suits, loses its vitality. Those tax dollars never unconditionally belonged to the Treasury in the first place. For this reason, there is no conceivable basis for supporting Section 641,

21. Congress itself recognized the discriminatory effect of Section 641 and attempted to remedy this discrimination problem by including a reporting provision in Section 642 of the Deficit Reduction Act of 1984 for all taxpayers. Section 642 requires taxpayers to report the transfers of public housing bonds which occur between December 31, 1983 and June 19, 1984 "if it is ultimately determined that such transfers are subject to estate, gift or generation-skipping tax." However, according to the Report of the Joint Committee on Taxation, this provision was to be enforced upon the condition that *Haffner* was overruled, and was therefore never brought into effect.

which has a flawed legislative purpose. Even under a minimal standard of review, the lack of a legitimate basis renders this statute unconstitutional. *United States v. Maryland Savings-Share Ins. Corp.*, 400 U.S. 4, 18 (1970); *Madden v. Kentucky*, 309 U.S. 83, 88 (1940).

CONCLUSION

What more could Congress have done when it enacted Section 5(e) in 1937 to make its intent clear? Apparently, the Government would insist that an exemption from "all taxation" cannot mean *all* taxation unless Congress adds "(and we really mean it!)" to the statute.

For the reasons stated in *Haffner v. United States*, in the decision by the Central District of California in this case and herein, the judgment of the district court should be affirmed.

Respectfully submitted,

ROBERT I. WHITE
1400 Citicorp Center
1200 Smith Street
Houston, Texas 77002
(713) 658-1818
Counsel for Amici Curiae The Estate of Dorothy G. Dillon and The Estate of Velma C. Gubbels

Of Counsel:
SHELLEY CASHION
CHAMBERLAIN, HRDLICKA, WHITE, JOHNSON & WILLIAMS
1400 Citicorp Center
1200 Smith Street
Houston, Texas 77002
(713) 658-1818

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AMICUS CURIAE

BRIEF

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Supreme Court of the United States

October Term, 1987

UNITED STATES OF AMERICA,

Appellant,

v.

WELLS FARGO BANK, *et al.*

UNITED STATES OF AMERICA,

Appellant,

v.

HARRY ROSENBERG and ARTHUR ROSEN, etc.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE CENTRAL DISTRICT OF CALIFORNIA

Brief *Amicus Curiae* of the American College of Probate Counsel in Support of Appellees

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JOHN A. WALLACE
Counsel of Record
2500 Trust Company Tower
Atlanta, Georgia 30303
(404) 572-4600

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No. 86-1521

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1987

UNITED STATES OF AMERICA,

Appellant,

v.

WELLS FARGO BANK, *et al.*,

UNITED STATES OF AMERICA,

Appellant,

v.

HARRY ROSENBERG and ARTHUR ROSEN, Etc.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE CENTRAL DISTRICT OF CALIFORNIA

Brief *Amicus Curiae* of The American College of Probate Counsel in Support of Appellees

The American College of Probate Counsel respectfully files this brief *amicus curiae* in support of Appellees herein. All parties have consented to the filing of this brief.

Interest of *Amicus Curiae*

The *amicus curiae,* The American College of Probate Counsel (the "College"), is a professional association of lawyers with a current membership consisting of almost 2,500 Fellows from throughout the United States who have been elected to membership by their peers on the basis of their professional reputation and their demonstrated exceptional skill and ability in probate, trust or estate planning law, and who have made substantial contributions to these fields through lecturing, writing, teaching and bar activities. The College has among its purposes "to maintain an association, international in scope, of lawyers skilled and experienced in the preparation of wills and trusts, estate planning, probate procedure and administration of trusts and estates of decedents . . .; to improve and reform probate, trust and tax laws, procedures and professional responsibility; . . . and to cooperate with bar associations and other organizations with similar purposes." Since 1975, representatives of the College have regularly contributed to the development of the gift, estate and generation-skipping tax laws of this country ("transfer taxes"), through presentations to representatives of the Executive Branch and Congress.

The policy of the College is to file *amicus curiae* briefs only on matters "of special significance to the legal profession or the public." The governing board of the College believes that the question of the possible retroactive effect of the federal statutory provision challenged in these cases has such significance. The College as *amicus curiae* is concerned that if the Court reaches the constitutional issues presented by the Government as the basis for its direct appeal from the United States District Court for the Central District of California, a finding by the Court that Section 641(b)(2) of the Deficit Reduction Act of 1984 is constitutional will effectively eliminate the Fifth Amendment from consideration by Congress when it adopts retroactive legislation affecting the collection and administration of transfer taxes.

Statement of the Case

It is appropriate in this bicentennial year of the United States Constitution that the Court has accepted an appeal on an issue that is vital to the role of the rule of law in a free society. This case involves a citizen's fundamental right to own and dispose of his property without fear of an unanticipated retroactive transfer tax.

Section 641 of the Deficit Reduction Act of 1984, Pub. L. No. 98-369, 98 Stat. 494 ("DEFRA"), was inserted into DEFRA in the final weeks before its enactment for the purpose of overruling the holding of *Haffner v. United States,* 585 F. Supp. 354 (N.D. Ill. 1984), *aff'd,* 757 F.2d 920 (7th Cir. 1985). The *Haffner* decision held that certain obligations of public housing authorities issued under the United States Housing Act of 1937, 50 Stat. 888, were exempt from estate tax. Secton 641(a) of DEFRA overruled *Haffner* by providing generally that statutory exemptions from taxation do not extend to transfer taxes. Section 641(b)(2) made the section retroactive with respect to any transfer of property that has been reported on an estate or gift tax return.

The district court in the instant cases agreed with the *Haffner* court that the 1937 Housing Act exempted local

housing obligations from estate tax. *Rosenberg v. United States*, 86-2 U.S. Tax Cas. (CCH) ¶13,703 at 86,283 (C.D. Cal. 1986). The district court further concluded that §641(b)(2) violates the Due Process Clause by retroactively imposing estate tax on property that had been exempt from such tax at the death of the decedents who owned the property. *Id.*

Summary of Argument

Section 641 is fundamentally unfair, both because it imposes a transfer tax retroactively on a completed transfer, and because it unfairly imposes that tax on the basis of executors' reporting positions. The Court therefore should invalidate §641(b)(2) under the Due Process Clause of the Fifth Amendment.

This Court has long recognized a heightened concern for fundamental fairness when Congress attempts to impose a retroactive tax on a gratuitous transfer of property. The Due Process Clause of the Fifth Amendment prohibits Congress from subjecting such transfers to taxation by legislation enacted after the transfer is complete. The College submits that the Court should reaffirm the vitality of this rule in the present cases, since §641 would act retroactively to impose estate tax on property that was exempt from such tax when it was acquired by Appellees' decedents, and that was exempt from such tax when it was transferred at their deaths.

In order to impart a retroactive effect to the anti-*Haffner* legislation, Congressional tax writers chose to abrogate the right of executors to file claims for refunds with respect to housing obligations that have been reported at any time on an estate or gift tax return. This approach was adopted in an apparent attempt to skirt Due Process constraints on an express imposition of a retroactive transfer tax. Fundamental notions of fairness are offended when the drafters of legislation seek to circumvent the precedents of this Court through such indirect means.

The decision to base the retroactivity of §641 on the reporting positions taken by executors compounded the Constitutional infirmities of the section in a number of ways. First, the Treasury Department in a 1981 public ruling prescribed that housing obligations such as those at issue in the present cases should be reported on their owner's estate tax returns. Section 641(b)(2) is fundamentally unfair for later penalizing such Governmentally prescribed conduct. In addition, the statutory right of an executor to sue for a refund becomes vested when the estate tax return is filed. Such vested causes of action have been recognized as property rights entitled to Due Process protection. Consequently, the arbitrary abrogation of refund rights by §641 is unconstitutional.

Finally, §641 would make it impossible for a diligent fiduciary to discharge his duties responsibly under state law. The section would produce an avoidable tax liability based on a reporting decision that itself had been mandated by a state law duty to avoid unnecessary litigation, expense and tax penalties. This whipsaw effect on fiduciaries is yet another fundamental unfairness attributable to §641.

Argument and Citation of Authorities

The circumstances surrounding the enactment of §641 were conducive to the adoption of an ill-advised provision. The opinion of Judge Will in *Haffner v. United States*, 585 F. Supp. 354 (N.D. Ill. 1984), *aff'd* 757 F.2d 920 (7th Cir. 1985), was filed on April 25, 1984. On May 17 the Senate passed H.R. 4170, which was to become the Deficit

Reduction Act of 1984, without inclusion of the anti-*Haffner* provision later enacted as §641. On June 22, 1984, the Conference Committee reported a 1000 page bill, which for the first time contained §641. The Deficit Reduction Act was signed into law shortly thereafter, on July 18, 1984.

Thus, §641 was added to a voluminous tax bill during the final weeks before passage of the Act, without the benefit of public hearings or other public input. The retroactive feature of the provision, and in particular its effect in denying the longstanding statutory right to file a claim for refund, was not the subject of any committee report, other than a single statement of its terms in the Conference Committee Report, and apparently the section received no comment from any Congressman during the process of the bills' enactment into law. Under these circumstances, it is perhaps not surprising that Congress attempted by enacting §641 to impose a tax that is constitutionally flawed for the two fundamental reasons discussed below.

I. The Rule of Law Restricting Congress in the Adoption of Retroactive Transfer Taxes Should be Re-Affirmed

The College urges the Court to reaffirm the rule of law that restricts Congress in the adoption of retroactive transfer taxes. Members of the College counsel daily with persons who must decide how to order their affairs within the transfer tax system. This process of estate planning evolves out of an acceptance of the maxim articulated over fifty years ago: "the legal right of a taxpayer to decrease . . . his taxes . . . is undoubted." *Gregory v. Helvering*, 293 U.S. 465, 469 (1935).

Due Process concerns are heightened in the context of estate planning, because such planning assumes a permanence that is foreign to other tax burdens. Unlike estate planning, income tax planning is fluid and ongoing. Taxpayers anticipate that the Government will continually tax their income to support public purposes, and that the rules by which income is taxed will change to meet evolving circumstances. Taxpayers regularly adjust their activity in response to such changes, and this is a natural adjunct to continuing participation in productive life.

A gratuitous transfer of the bulk of one's property is, by contrast, a highly exceptional event, often as singular as death itself. A person ideally casts his estate plan once, or on only a few occasions. On these occasions, he must bring into view many concerns, including the need for sufficient liquidity and a regard for how his property will be held and managed to serve the needs of his beneficiaries. Also among his concerns, and often paramount, is the effect of transfer taxes.

The effect of transfer taxes can be dramatic and dispositive. While income taxes relate to discrete segments of economic life, transfer taxes fall across the full range of a person's property. As a result, an estate plan can be distorted beyond all recognition by an unanticipated transfer tax. Thus, fundamental fairness in regulating gratuitous transfers depends entirely on the principle that Congress may not retroactively change the rules that apply to a completed transfer.

The Court early recognized this principle in *Nichols v. Coolidge*, 274 U.S. 531 (1927), which invalidated an estate tax imposed on a transfer with a retained life interest, since the transfer had been completed before the taxing statute was enacted. The Court was mindful in *Nichols v. Coolidge* of the effects that a retroactive transfer tax can

have on a decedent's overall estate plan. "Property of small value transferred before death may have become immensely valuable, and the estate tax, swollen by this, may leave nothing for distribution." *Id.* at 542.

The Court relied on *Nichols v. Coolidge* later that same year to invalidate a gift tax imposed on transfers completed before enactment of the tax. *Blodgett v. Holden*, 275 U.S. 142 (1927). The eight Justices who participated in the decision of *Blodgett v. Holden* were evenly divided about the proper grounds for invalidating the tax, however, and consequently the opinion of Justice McReynolds holding the tax unconstitutional was later modified to retract this definitive result. 276 U.S. 594 (1928). The Court reached a definitive conclusion about the gift tax the following year, though, in *Untermyer v. Anderson*, 276 U.S. 440 (1928), holding that retroactive application of the tax would be "arbitrary and invalid under the due process clause of the Fifth Amendment." *Id.* at 445.

Justice McReynolds, who authored the opinions in *Nichols v. Coolidge*, *Blodgett v. Holden*, and *Untermyer v. Anderson*, readily recognized the fundamental difference between retroactive transfer taxes and retroactive income taxes. In *Cooper v. United States*, 280 U.S. 409 (1930), Justice McReynolds wrote for a unanimous Court to uphold a statute that altered certain basis rules for capital gains purposes, even though the amending statute applied to sales made before the date of its enactment. In holding the statute constitutional, the Court noted that the transfer tax cases were not in point, and that there was "nothing unusual, arbitrary or capricious" about the retroactive change in income tax basis rules. *Id.* at 412.

The important distinction between income taxes and transfer taxes was emphasized in *Welch v. Henry*, 305

U.S. 134 (1938), in which the Court acknowledged its precedent concerning transfer taxes, but noted that "there are other forms of taxation whose retroactive imposition cannot be said to be similarly offensive, because their incidence is not on the voluntary act of the taxpayer." *Id.* at 147. In light of this difference between the nature of the activities taxed, the Court upheld a Wisconsin income tax imposed on dividends received in the year prior to the year of enactment of the taxing statute. *See also United States v. Darusmont*, 449 U.S. 292, 299 (1981) ("These . . . are gift tax cases [and] we do not regard them as controlling authority with respect to any retroactive feature of a federal income tax.")

The Court has also held, however, that, while transfer taxes present unique Due Process concerns, such taxes may be retroactively modified, if the effect is not to impose a new tax. Thus, in *Milliken v. United States*, 283 U.S. 15 (1931), the Court considered the constitutionality of a statute taxing gifts made in contemplation of death at rates higher than the rates under a predecessor statute that had been in force when the gifts were made. The Court upheld application of the higher rates, noting that the gift had been "subject to the provisions of the [earlier] Act," *id.* at 22, and that the decedent "should be regarded as taking his chances of any increase in the tax burden." *Id.* at 23.

The Court recently relied on *Milliken* to validate another change in transfer tax rules. In *United States v. Hemme*, 106 S. Ct. 2071 (1986), transitional rules affecting a decedent's unified credit amount for transfer tax purposes were upheld against a Due Process challenge. The Court considered in detail the economic effect of the change on the decedent's transfer tax liability, and concluded that his position was actually improved by the new

legislation. *Id.* at 2079. The Court declined to decide whether the statute in question amounted to retroactive taxation, *id.* at 2079-80, but concluded that the provision was constitutional in any event because its application was not harsh and oppressive. *Id.* at 2078-80.

The College believes that the relevance of *Hemme* to the present cases rests primarily in the distinction it draws between "certain changes in the operation of the tax laws" and "the creation of a wholly new tax." *Id.* at 2078. The Court did not elaborate in *Hemme* on the appropriate standard for drawing this distinction. *See id.* at 2078. The College submits, however, that a statute that would subject previously exempt property to estate tax should be considered to impose a "wholly new tax" for purposes of determining the statute's constitutionality.

A person is unfairly treated when a completed transfer of his property is taxed retroactively. The unfairness is not removed because other property owned by him was subject to tax at the time the exempt property was transferred. The relevant concern for Due Process purposes is whether the rules that applied when the property was transferred subjected that voluntary act to tax. The Court may have suggested this conclusion in *Hemme*: "Our first task . . . is to determine whether [taxpayer's] conduct was granted a different and more oppressive legal effect as a result of the [challenged legislation]." 106 S. Ct. at 2078. A statute subjecting exempt property to estate tax after the property has been irrevocably transferred produces a dramatically different legal effect, and it consequently should be considered to impose a new tax for Due Process purposes.

The United States presents several conclusions to this Court concerning whether decedents acquired their public housing obligations in reliance on the exempt status of the

bonds, and whether executors who reported the bonds thereby evinced a belief that they were taxable. *See* Brief of the United States at 39-44. The College urges the Court not to decide the Constitutional questions raised in the present cases on the basis of any such generalized assumptions. There may well have been many decedents who acquired public housing obligations in a belief that the bonds were not subject to estate tax, and the conduct of executors is at best only an unreliable indication of decedents' motives while in life. In addition, taxpayers in these cases have well argued that one cannot reliably impute to executors a belief about ultimate taxability on the basis of their reporting positions. *See* Memorandum of Appellees Crocker National Bank, et al. in response to Jurisdictional Statement of the United States at 14. The College submits that attention to factors such as the motives of decedents and the beliefs of executors would tend to lead this Court into highly speculative factual conclusions, and that such conclusions can furnish no solid ground on which to determine the constitutionality of §641.

In summary, §641 violates the Due Process Clause because it would impose an estate tax on property that was exempt from such tax when it was acquired by the decedent, that was exempt from such tax when the decedent planned his estate, and that was exempt from such tax when the plan was implemented at his death. The Constitution will not permit an act of Congress thus to upend affairs that have been permanently shaped around existing law.

II. Congress Should not be Permitted to Circumvent the Due Process Clause and the Precedents of this Court by the Device of Withdrawing the Right to File a Claim for Refund

The College submits that in drafting §641 Congressional tax writers attempted to meet Due Process concerns and the precedents of this Court by a mechanism that only compounds the Constitutional infirmities of the section. Section 641(a) restrictively interprets the meaning of every federal statute in force that contains an exemption from tax, thereby reaching the result the Government unsuccessfully sought in *Haffner*. This new meaning of "exempt from all tax" is made applicable only to transfers occurring on or after June 19, 1984. §641(b)(1). The College maintains that under the authority discussed in Part I, above, the Due Process Clause would not have permitted this change to be made explicitly retroactive, and this appears to have been the conclusion reached by the drafters of §641 as well.

Section 641(b)(2) was inserted in the statute, however, in an apparent attempt to skirt Constitutional constraints by making the new interpretation only selectively retroactive. Section 641(b)(2) limited the retroactive reach of §641(a) to earlier transfers that have been reported at any time on an estate or gift tax return. Thus, the section would effectively prevent the filing of a claim for refund by estates that have reported the bonds, thereby unfairly penalizing such estates on the basis of the lawful reporting conduct of their fiduciaries. This approach is fundamently unfair for at least three reasons.

First, the imposition of estate tax by §641 on the basis of reporting positions is inconsistent with an earlier ruling of the Treasury Department that would require executors to

report public housing obligations on estate tax returns. *See* Rev. Rul. 81-63, 1981-1 C.B. 455. In essence, one branch of the Government prescribed a course of conduct another branch now would penalize. The College submits that the injustice in imposing a penalty under such circumstances is apparent.

Second, the tax writers' decision to base the retroactive effect of §641 on reporting positions abrogates the vested rights of estates to sue for refunds. The cause of action for a refund of estate taxes accrues when the statute of limitations begins to run upon the earlier of the filing of the estate tax return or payment of the tax. *See* I.R.C. §6511(a); *see also Karl v. Bryant Air Conditioning Co.*, 705 F.2d 164, 173 (6th Cir. 1983) (once a cause of action accrues, it becomes a vested right). Such vested causes of action are recognized as a type of property protected by the Due Process Clause. *See Logan v. Zimmerman Brush Co.*, 455 U.S. 422, 428 (1982) (a cause of action is a constitutionally protected species of property). Although several lower courts have upheld retroactive tax statutes based on eliminating a refund right relating to F.I.C.A. taxes, in each case insurmountable administrative burdens furnished a countervailing public interest favoring the method chosen. *See New England Baptist Hospital v. United States*, 807 F.2d 280 (1st Cir. 1986); *Canisius College v. United States*, 799 F.2d 18 (2d Cir. 1986), *cert. denied*, No. 86-1187 (Apr. 20, 1987); *Temple University v. United States*, 769 F.2d 126 (3d Cir. 1985), *cert. denied*, No. 85-1401 (June 16, 1986). No such administrative burdens are present with respect to the estate taxes involved in the present cases.

Third, the approach taken in §641(b)(2) places diligent fiduciaries in an unfairly compromised position under state law. An executor who did not report his decedent's

public housing obligations as taxable would be subject to the criticism that he had exposed his decedent's estate to litigation with the Government that was duplicative and unnecessary. This criticism arises from the prospect that the *Haffner* issue was likely to be resolved definitively in other cases before the time for claiming a refund for his estate had expired. In addition, refusing to pay the tax could result in interest and penalties, which a prudent executor would strive to avoid. If §641(b)(2) is upheld, however, the prudent executor will now be subject to the criticism that he paid tax unnecessarily since the tax could have been avoided entirely if the bonds had not been reported. This whipsaw effect on diligent fiduciaries is yet another example of the unfairness that can be attributed to §641.

In short, the refund abrogation approach taken by §641(b)(2) is ill-considered and fundamentally unfair. It conflicts with the long-established statutory policy of the Internal Revenue Code regulating tax refund suits, which has created vested rights that cannot be arbitrarily abridged. It also unfairly burdens the difficult task of fiduciaries, who must observe the strictest standards of conduct known to state law while charting a prudent course through federal tax rules. In short, §641, which penalizes diligent fiduciaries and the estates they represent based solely on lawful and governmentally prescribed conduct, is harsh and oppressive. In subjecting estates administered by such fiduciaries to additional tax, and in depriving such estates of their vested right to sue for a refund, §641 violates the Due Process Clause of the Fifth Amendment.

CONCLUSION

The 98th Congress went too far in approving the anti-*Haffner* legislation as a cure for the perceived error of the 75th Congress in granting an estate tax exemption under the Housing Act of 1937. The College urges the Court to declare that §641, as applied retroactively by §641(b)(2), violates the Due Process Clause of the Fifth Amendment.

Respectfully submitted,

JOHN A. WALLACE
Counsel of Record for *Amicus Curiae,*
The American College of Probate
Counsel

AMICUS CURIAE

BRIEF

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On Appeal from the United States District Court for the Central District of California

BRIEF OF KEITH D. GRAHAM AS *AMICUS CURIAE* IN SUPPORT OF APPELLEES

Daniel Joseph, P.C.*
Jerry E. Rothrock
Bob C. Griffo
W. Thomas Reeder, Jr.
AKIN, GUMP, STRAUSS, HAUER & FELD
1333 New Hampshire Ave., N.W.
Suite 400
Washington, D.C. 20036
(202) 887-4000
Counsel for Amicus Curiae
*Counsel of Record

QUESTIONS PRESENTED

1. Whether Section 641(b)(2) of the Deficit Reduction Act of 1984 violates the fifth amendment because it applies retroactively to some taxpayers but not to others.

2. Whether transfers of obligations of public housing agencies issued in connection with low-rent housing or slum clearance projects are exempt from transfer taxation by virtue of the United States Housing Act of 1937, as amended.

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On Appeal from the United States District Court for the Central District of California

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BRIEF OF KEITH D. GRAHAM AS *AMICUS CURIAE* IN SUPPORT OF APPELLEES

INTEREST OF AMICUS CURIAE

Keith D. Graham respectfully submits this brief in support of Appellees. On file with the clerk of this Court are letters from counsel for Wells Fargo Bank, *et al.*, Harry

Rosenberg, etc., and the United States, indicating their consent to the filing of this brief. Graham has been held by the Internal Revenue Service to owe taxes on the transfer by gift of certain obligations of a local housing authority [hereinafter Project Notes], issued pursuant to the Housing Act of 1937, as amended, Pub. L. No. 412, 50 Stat. 888 (1937) [hereinafter the Housing Act]. The Housing Act provides that Project Notes shall be exempt from all taxation. Like Appellees, Graham maintains that Congress intended that the transfer of the Project Notes, by gift, descent, or bequest, be tax exempt.

Unlike the Appellees' position, however, the exemption from transfer taxes for Graham is unaffected by the Deficit Reduction Act of 1984, Pub. L. No. 98-369, 98 Stat. 494 (1984) [hereinafter DEFRA]. Graham's Project Notes were transferred prior to the effective date of DEFRA and the transfer was reported in compliance with the reporting requirements of Section 642 of DEFRA. Therefore, the determination of the constitutionality of Section 641(b)(2) of DEFRA does not affect Graham's tax liability. The transfer of Graham's Project Notes will be taxable only if the holding of the court below concerning the transfer tax exemption of the Housing Act is reversed. Accordingly, this brief only addresses such transfer tax exemption.[1]

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[1] The Government did not petition for a writ of certiorari following *Haffner v. United States*, 757 F.2d 920 (7th Cir. 1985), in which the court held that Project Notes were exempt from transfer taxes. Nevertheless, the Government now desires to argue the merits of that decision before this Court. The Government suggests that this Court should avoid the constitutional issue presented, if possible, by first deciding the construction of a statute whose constitutionality is not under attack and whose construction is not disputed by the circuits. The constitutionality of Section 641(b)(2) of DEFRA can be avoided more appropriately by construing that provision not to apply to taxpayers who filed transfer tax returns prior to the effective date of that provision.

STATEMENT

In two separate suits for refund, Appellees challenged the constitutionality of Section 641(b)(2) of DEFRA. That section provides that a transfer of Project Notes before June 19, 1984, will be taxable if "there was filed an estate or gift tax return showing such transfer as subject to Federal estate or gift tax." Section 641(b)(1) of DEFRA provides that the transfer of Project Notes after June 18, 1984, will not be exempt from transfer taxes.[2]

The suits of Appellees in the instant case were consolidated and the District Court for the Central District of California held Section 641(b)(2) to be a violation of the due process clause of the fifth amendment. Since the government also attacked the validity of the claimed estate tax exemption, the court below was obligated to rule on whether transfers of

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[2] Section 641 of DEFRA was a response to the district court's decision in *Haffner v. United States*, 585 F. Supp. 354 (N.D. Ill. 1984). In that case, the executors of the estate of Charles Haffner, Jr., successfully sued for a refund of taxes assessed by the Internal Revenue Service on the value of Project Notes held by the estate, on the grounds that such Project Notes were exempt from transfer taxes. Subsequent to the enactment of DEFRA, the court of appeals affirmed *Haffner* in a *per curiam* decision, adopting, with minor corrections, the "detailed and well reasoned opinion" of the district court. 757 F.2d 920 (7th Cir. 1985).

transfers of Project Notes prior to June 19, 1984, were exempt from transfer taxes. With respect to the estate tax exemption, the court adopted as "persuasive" the reasoning and analysis of the district court's opinion in *Haffner v. United States*, 585 F. Supp. 354 (N.D. Ill. 1984). J.S., App. A, 18a. This Court noted probable jurisdiction under 28 U.S.C. § 1252 on May 18, 1987, on the grounds that the district court in the instant case had declared Section 641(b)(2) of DEFRA to be unconstitutional.

SUMMARY OF ARGUMENT

The language of the Housing Act evidences a clear congressional intent to exempt Project Notes from transfer taxes. Section 5(e) of the Housing Act exempts Project Notes from "all taxation." As clear evidence that "all taxation" includes transfer taxes, these taxes were excepted from the coverage of that phrase elsewhere in the same act. Moreover, since the only federal taxes ever imposed on obligations, as opposed to income from obligations, have been excise taxes, an exemption from all federal taxation for obligations can only be an exemption from excise taxes, which include estate, gift, and inheritance taxes.

In addition, the legislative history of the Housing Act confirms that Congress intended to provide special tax treatment for Project Notes. Together, the words of the Housing Act and the legislative history form an overwhelming basis for affirming the decision of the court below that Project Notes are exempt from all taxation, including transfer taxes.

ARGUMENT

I. THE PLAIN LANGUAGE OF THE HOUSING ACT OF 1937 REQUIRES THAT PROJECT NOTES BE EXEMPTED FROM TRANSFER TAXATION

Section 5(e) of the Housing Act expressly exempts Project Notes from "all taxation." The second sentence of Section 5(e) of the Housing Act provided:

> *Obligations, including interest thereon*, issued by public housing agencies in connection with low-rent housing or slum clearance projects, and the income derived by such agencies from such projects, shall be *exempt from all taxation* now or hereafter imposed by the United States. (Emphasis added.)[3]

Since transfer taxes on the "[o]bligations" are includable in the phrase "all taxation," the statute itself indicates that the Project Notes in question in the instant case are exempt from transfer taxes.

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[3]Section 5(e) of the Housing Act of 1937 was renumbered as Section 11(b), but not changed with respect to the wording discussed in the instant case, by the Housing and Community Development Act of 1974, Pub. L No. 93-383, 88 Stat. 633 (1974) (codified at 42 U.S.C.A. § 1437i(b)(West 1978 and Supp. 1987)).

A. The Government's Interpretation of the Phrase "All Taxation" in Section 5(e) of the Housing Act Is Inconsistent with the Plain Meaning of the Phrase Elsewhere in the Act

While the Government concedes that Congress has the power to exempt any property from estate taxation, it argues that such an exemption must be explicit to assure that Congress' intention is not misunderstood. Brief for Appellant at 17. It is the Government's argument that the language of Section 5(e) is capable of a construction limiting the exemption to income taxation, not "all taxation." As the Government concedes, and the *Haffner* court held, *Murdock v. Ward*, 178 U.S. 139 (1900), announced only a rule for assuring proper divination of congressional intent, and the result in that case does not apply when Congress' intention to exempt transfer taxes is clear.[4] That is the case here. When Section 5(e) is read in the context of the rest of the statute, it explicitly provides such an exemption. "[T]he whole statute is the context for construction of any of its individual sections." *Haffner*, 585 F. Supp. at 358.

As clear evidence that the phrase "all taxation" included estate and gift taxes, these taxes were excepted from

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[4] None of the cases cited by the Government in support of its position involve the construction of a statute with either an equivalent of the Housing Act's Section 20(b) (set forth at page 7 hereof) or the explicit legislative history here present. Brief for Appellant at 18-19 n.7. All of the cases construe language which simply exempts various items from all taxation. None of the statutes have other language excepting transfer taxes from an exemption from "all taxation."

the coverage of that phrase in Section 20(b) of the same act. Referring to obligations of the United States Housing Authority, which was created by the Housing Act, Section 20(b) provided:

> Such obligations shall be exempt, both as to principal and interest, from *all taxation (except surtaxes, estate, inheritance, and gift taxes)* now or hereafter imposed by the United States or by any State, county, municipality, or local taxing authority. (Emphasis added.)

Two well established rules of statutory construction work to highlight the exemption from transfer taxes provided by Section 5(e). First, "[i]t is a cardinal rule of statutory construction that significance and effect shall, if possible, be accorded to every word." *Market Co. v. Hoffman*, 101 U.S. 112, 115 (1879). "All taxation" in Section 5(e) must include that which is excepted from the same phrase in Section 20(b). Otherwise, the words "except . . . estate, inheritance, and gift taxes" in Section 20(b) would have no significance or effect. In the words of Chief Justice Marshall, "the exception of a particular thing from general words proves that, in the opinion of the lawgiver, the thing excepted would be within the general clause, had the exception not been made." *Brown v. Maryland*, 25 U.S. (12 Wheat.) 419, 438 (1827). Second, "every part of a statute must be construed in connection with the whole." 101 U.S. at 116. Accordingly, the drafters had Section 5(e) in mind when they drafted section 20(b). To attempt to interpret those sections of the Housing Act independently, as the Government has done, is to deny the

harmony of the Housing Act. "All taxation" in Section 20(b) must mean the same as "all taxation" in Section 5(e).

The Government argues that the sole reason that Congress inserted the parenthetical phrase in Section 20(b) was to assure that interest on obligations of the Federal Housing Authority would be subject to the surtax. The addition of "estate, inheritance, and gift taxes" to the parenthetical, the Government argues, does not exclude anything more from the meaning of the phrase "all taxation" because such phrase generally excludes transfer taxes. To the Government, the meaning of the phrase "all taxation (except surtaxes)" would be the same as the phrase "all taxation (except surtaxes, estate, inheritance, and gift taxes)." Brief for Appellant at 27-28. This, we respectfully submit, is fanciful. The Government argues that Congress feared that without the explicit mention of estate, inheritance, and gift taxes, Section 20(b) would have made those taxes arguably includable among the taxes exempted. Brief for Appellant at 28. But this argument applies with equal force to Section 5(e)'s wording, particularly since Section 20(b) was also in the Act. Thus, if the Government's argument were valid, the careful draftsmen would have been just as explicit in Section 5(e). The Government's argument really is that this Court must find that Congress was careful in drafting Section 20(b) but not Section 5(e) of the same statute. Other than by reasoning backwards from its derived result, the Government has nothing to support its position. Moreover, as we detail below, every piece of legislative history supports the district court's decision.

The only statute that has been judicially construed that contained both an unqualified exemption from "all taxation" in one section and a qualified exemption from "all taxation" in a different section, was the Victory Liberty Loan Act, 40 Stat. 1311 (1919). *Jandorf's Estate v. Commissioner*, 171 F.2d 464 (2d Cir. 1948).[5] In holding that the unqualified exemption from "all taxation" included an exemption from transfer taxes, the Second Circuit (Swan, J.) said that

> "[t]he use of the same words of exemption in different sections of the same statute with an expressly declared exception in one case and not in the other, is a strong indication that the Congress thought the exception necessary in order to exclude estate and inheritance taxes from the broad words of the exception provision."

Id. at 466. That holding is fully applicable here.[6]

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[5] *Jandorf* was followed in *Hartford-Connecticut Trust Co. v. United States*, 212 F.2d 485 (2d Cir. 1954), *Chemical Bank and Trust Co. v. Pedrick*, 185 F.2d 1022 (2d Cir. 1951), *Pennsylvania Co. for Banking and Trusts v. United States*, 185 F.2d 125 (3d Cir. 1950), and *Claflin v. Commissioner*, 186 F.2d 307 (2d Cir. 1951).

[6] The Government dismisses *Jandorf* as inapplicable to the instant case because the Second Circuit also relied upon a Treasury Regulation exempting the obligations. Brief for Appellant at 30 n. 17. But such regulation was the result of a district court's prior decision in *Farmer's Loan and Trust Co. v. Bowers*, 22 F.2d 464 (S.D.N.Y. 1927) *rev'd on other grounds* 29 F.2d 14 (2d Cir. 1928). The *Jandorf* decision reaffirmed the *Farmer's Loan* decision and further held that a change in the income tax treatment of the United States Bonds did not affect the estate tax exemption.

B. When Congress Exempted "Obligations" from Federal Taxation, It Could Only Have Been Referring to Transfer Taxation

The fact that Congress used the phrase "[o]bligations, *including the interest* thereon" (emphasis added) in Section 5(e) is further confirmation of Congress' intent to exempt Project Notes from transfer taxation. The phrase "including the interest" is a recognition that interest is a component of the obligations. Interest is income which, in the absence of a statutory exemption, would be subject to income tax. The obligation itself is property, not income. The only methods that have ever been used by the federal government to tax obligations, as opposed to income from obligations, have been excise taxes -- most notably, gift, estate, and inheritance taxes, which are excises on the transfer of property. *Greiner v. Lewellyn*, 258 U.S. 384, 387 (1922).[7] Therefore, when the 75th Congress explicitly exempted "obligations . . . from all

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[7] Moreover, every income tax since 1913 has explicitly exempted interest on obligations of state and local governments. 1 B. Bittker *Federal Taxation of Income, Estates and Gifts* ¶ 1.2.8 (1981). Although later there was an issue as to whether bonds of public corporations were those of state and local governments, in 1937 the bonds of local housing authorities were considered as those of local government, and the interest on such bonds were therefore already exempt from federal income taxation. Tretter, *Public Housing Finance*, 54 Harv. L. Rev. 1325, 1326 n.4 (1941).

taxation," it could only have been referring to excise taxes.[8] If Congress' intention was that which the Government now ascribes, Congress could more simply and accurately have exempted "interest on the obligations" rather than "obligations including interest," as it did in I.R.C. § 22(b)(4) (1939).

This Court has never held that Congress *could* not exempt *any* item from transfer taxation. It was just such an exemption that Congress provided in the United States Housing Act of 1937, and that the Government is now attempting to foil.[9]

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[8] None of the cases cited by the Government in support of its position construes a federal statute exempting any kind of obligation from all taxes at the *federal* level *only*. Section 20(b) applied to obligations of the U.S. Housing Authority, and the exemption was for taxes at all levels of government -- federal, state, and local. Since some state and local governments directly taxed personal property, Section 20(b) exempted obligations of the U.S. Housing Authority from state or local personal property taxes.

[9] Although the Government argues that the *Haffner* court discovered the transfer tax exemption after it had lain dormant for over forty years, it offers no evidence for that assertion. Brief for Appellant at 35. Not until DEFRA were any Project Notes required to be issued in registered form. DEFRA § 628(a). Nothing suggests that individuals were not giving or bequeathing Project Notes in bearer form without paying transfer tax.

Moreover, since the plain meaning of the phrase "exempt from all taxation," as well as the legislative history of the Housing Act, was enough justification for four district courts and a court of appeals to determine that taxpayers need not report transfers of the Project Notes to the Internal Revenue Service, it is common sense to conclude that many taxpayers could come to the same conclusion. In addition to the district court in the instant case and the district court and court of appeals in

II. THE LEGISLATIVE HISTORY OF THE HOUSING ACT OF 1937 CONFIRMS THAT CONGRESS INTENDED TO EXEMPT PROJECT NOTES FROM TRANSFER TAXATION

The legislative history of the Housing Act confirms the intent of the 75th Congress to provide a tax exemption different from that which had been provided other state and local obligations. Other than the plain language of the statute, the clearest evidence of Congress' intent to exempt Project Notes from transfer taxation was Senator Walsh's explicit explanation of Section 5(e) of the Act on the floor of the United States Senate:

> Obligations, including interest thereon, issued by public housing agencies, and income derived by such agencies on such projects are to be exempt from all taxation now or hereafter imposed by the United States. *In other words, the bill gives the public housing agencies the right to issue tax-exempt bonds, which means they are free from income tax, surtax, estate, gift and inheritance taxes.*

81 Cong. Rec. 8085 (1937) (emphasis added). This explanation is best described by the district court in *Haffner* as "straightforward, unambiguous and emphatic." 585 F. Supp. at 359.

Haffner, Project Notes were held to be exempt from transfer taxes in *Estate of Bradford v. United States*, 645 F. Supp. 476 (N.D. Cal. 1986), and *Netsky v. United States*, 652 F. Supp. 783 (E.D. Pa. 1986).

The Government nonetheless argues, as it did in *Haffner*, that Senator Walsh's statement should be simply disregarded. The only reason given for this unusual rule of divining congressional intent is the Government's speculation that Senator Walsh was apparently somehow misinformed. Brief for Appellant at 32. The Government does not explain how Senator Walsh could have been misinformed about what he himself intended.

Here again, we must respectfully suggest that the Government's argument is unworthy. Other than the bill's sponsor, Senator Robert Wagner, Senator Walsh must have known more about the bill than any other senator. For four years prior to 1937, Senator Walsh was the chairman of the Senate Education and Labor Committee, and presided over the committee hearings which heard testimony on other proposed housing bills. He had served for 18 years on that Committee. *Official Congressional Directories* (1919-1937). More importantly, Senator Walsh was the acting chairman, overseeing the hearings of the 1937 Housing Bill, in the absence due to illness of the chairman, then Senator Hugo Black. Contrary to the Government's allegation that "Senator Walsh was a vocal opponent of some of [the Act's] provisions" (Brief for Appellant at 33), Senator Walsh was adamantly in favor of the entire Housing Act as passed. He had voiced his concern with certain provisions and he was especially eager to include provisions for slum clearance. It was his "earnest conviction that any housing program of the Federal Government involving the expenditure of Government funds should be focused primarily upon the elimination of our slum areas." 81 Cong. Rec. at 8090. In fact, he

became a Senate conferee for the bill after the House of Representatives passed a slightly different version. *Id.* at 9297.[10] Senator Walsh was therefore not only in favor of the bill, but he was also chosen as a representative of the majority of the Senate favoring enactment.[11]

Senator Walsh also clearly understood the intricacies of the federal taxation of obligations such as the Project Notes. By 1937, he had served for 16 years on the Senate Finance Committee, the Senate's tax-writing committee. *Official Congressional Directories* (1921-1937). He was therefore quite familiar with federal taxation.[12] He was a member of the Finance Committee when this court delivered its opinions in *Greiner v. Lewellyn*, 258 U.S. 384 (1922), and *Willcuts v. Bunn*, 282 U.S. 216 (1931), and the court of appeals decided *Iglehart v. Commissioner*, 77 F.2d 704 (5th Cir. 1935), and *Phipps v. Commissioner*, 91 F.2d 627 (10th Cir.), *cert. denied*, 302 U.S. 742 (1937), all cited in

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[10] The wording of the tax exemptions in § 5(e) and 20(b) were identical in the versions passed by both houses. 81 Cong. Rec. at 8087, 9289.

[11] Conferees "are designated by friends of the measure, who are in sympathy with the prevailing view of the Senate." F. Riddick, Senate Procedure: Precedents and Practices, S. Doc. No. 2, 97th Cong., 1st Sess. 378 (1981).

[12] Perhaps that is why "several Senators asked [Senator Walsh] . . . to explain or to summarize the financial provisions of the bill." 81 Cong. Rec. at 8084.

Appellant's brief.[13] Given the courts' activity in the interpretation of similar language and Walsh's senior position on the Senate Finance Committee, it is inconceivable that he did not understand what he was saying when he explained Section 5(e). There is no reason for him to explain the term "tax-exempt" other than the fact that he knew that it was sometimes a term of art and he wanted to ensure that the Record reflected the particular meaning that the Education and Labor Committee intended. And the committee summary of the bill, presented to the presiding officer for publication in the Record, did nothing to alter the meaning enunciated by Walsh. 81 Cong. Rec. at 8086.[14]

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[13] Walsh was also a well qualified attorney, having graduated first in his class at the law school of Boston University. D. Wayman, *David I. Walsh, Citizen-Patriot* 22 (1952).

[14] That Senator Walsh's explicit explanation of Section 5(e) means exactly what he said is confirmed by Congress' failure to enact quite different legislation. During committee consideration of Wagner's proposed Housing Bill, Secretary of the Interior Harold Ickes proposed an alternate version of the bill. The second sentence of Section 5(e) of the Ickes version read, "Obligations issued by public housing agencies . . . shall be exempt from all taxation (except estate, inheritance and gift taxes) . . . ." *To Create a United States Housing Authority: Hearings on S. 1685 Before the Senate Committee on Education and Labor*, 75th Cong., 1st Sess. 56 (1937). Congress did not enact this version, although it was submitted for Congress' consideration.

The Government also argues that Senator Walsh did not know the intention of the bill because he was not familiar with this Court's decisions. Brief for Appellant at 32. The kindest thing that may be said about this argument is that it forgets whose obligation it is to interpret whose intention. It is the Court's obligation to discern and to honor the intentions of Congress. It is not the obligation of a Senator or of Congress, if they wish to have their intentions honored, to have intentions that are consistent with this Court's prior decisions interpreting statutes enacted by prior Congresses. Senator Walsh's comment was a statement clarifying that this tax exemption was different from those previously interpreted by the courts, as much as it was a statement describing the intent of the Committee. The important fact is that Senator Walsh's entire description of the bill followed his introductory remark that he was speaking for a majority of the Committee. 81 Cong. Rec. at 8076. It is the intent of the 75th Congress that determines the meaning of the Housing Act, not the intent of a previous or subsequent Congress, and no decisions of this Court limit what that intent may be in granting a tax exemption.

Moreover, the setting in which Senator Walsh described the tax exemption as being applicable to estate and gift taxes as well as income taxes was one in which those present would be paying attention. Senator Walsh's description was part of a debate taking up about ten pages of the Congressional Record. During that debate Senator Walsh yielded to comments and questions from twelve other senators at least twenty-four times. There was a comment or a question from Senator Wagner, the sponsor of the bill, on seven of the ten pages of this debate on the bill. 81 Cong.

Rec. at 8076-8086.[15] Five of the twelve senators to whom Senator Walsh yielded were members of the Senate Finance Committee, and thus especially aware of the affairs of taxation. *Official Congressional Directory* (1937).

The history of the Housing Act contains an explicit and reliable confirmation of Congress' intent, of which the *Haffner* court was apparently unaware. Within one month after President Roosevelt signed the bill into law, another individual who was intimately involved in the technical aspects of the writing of the Housing Act, Warren Vinton, explained that it exempted Project Notes from transfer taxation. Vinton addressed a conference of the American Federation of Housing Authorities, Inc., in Washington, D.C. As part of his remarks, Vinton stated that "the obligations of the local Authorities . . . are exempt from all Federal taxes, not only normal income taxes but surtax, inheritance tax, and gift tax." That conference was attended by 37 officials representing 18 public housing agencies -- the very agencies addressed by Section 5(e) of the Housing Act. Following Vinton's remarks, there were significant questions and answers, filling some ten pages of transcribed material. American Federation of Housing Authorities, Inc., Summary Report of Conference of September 24-25, 1937, 17 (Libr. of Cong. no. HD 7286. A5 1937a). *See* App. 1a, 9a.

There is no valid reason to question Warren Vinton's understanding of the Housing Act. Vinton was a technical

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[15] In the middle of the debate, a quorum was called, and eighty-eight senators, including all 20 members of the Finance Committee, answered present. 81 Cong. Rec. at 8080.

expert who worked with Senator Wagner's administrative assistant, Leon Keyserling, in drafting the Housing Act in 1937. T. McDonnell, *The Wagner Housing Act, A Case Study of the Legislative Process*, 251 (1957). Vinton was also the chief of research for the Division of Suburban Resettlement of the Resettlement Administration at the time. When the Housing Act created the United States Housing Authority, he became its chief economist and later became the First Assistant Commissioner. 5 *Who Was Who in America* 745 (1973). Indeed, because Vinton was involved in writing the Housing Act as well as administering it, his construction of its meaning is especially persuasive. *See United States v. Board of Comm'rs*, 435 U.S. 110, 131 (1977). Just as importantly, Vinton's unambiguous remarks plainly dispel the Government's contention that the transfer tax exemption was not discovered until much later.

In sum, persons involved in four of the most important stages of legislation -- drafting and administration (Vinton) and committee hearings and floor debate (Senator Walsh) -- authoritatively vocalized the already clear intent of the tax exemption written in Section 5(e). More importantly, the groups who heard them -- those participating in Senate floor debate of the bill and the officials of the agencies addressed by the bill -- were people who would know if the Housing Act did not provide an exemption from transfer taxes for Project Notes. But no one in either group ever contradicted Senator Walsh or Warren Vinton when they unambiguously stated that the Housing Act provides such an exemption.

Moreover, exempting Project Notes from transfer taxes was a logical New Deal Congress' reaction to the desperate housing crisis of the Great Depression. It is difficult today to recall the desperate situation in housing, and the lack of financing for it, in the Great Depression. In a message to Congress, President Roosevelt wrote:

> Many of our homes are in decadent condition and not fit for human habitation. They need repairing and modernizing to bring them up to the standard of the times. Many new homes now are needed to replace those not worth repairing.

78 Cong. Rec. 8739 (1934). By the mid-1930s, housing for low-income persons had become a national issue, because those who were earning an income were earning much less than before the Depression, and the number of people without any income had greatly increased during the Depression.[16]

Compounding the problem of housing was the general inability of states and localities to deal with it. With the Depression came shrinking real estate values and, likewise, shrinking real estate tax collections. General obligation bonds defaulted at an unprecedented rate. Tretter, *supra*, at 1330. Because of the increasing inability to raise funds

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[16] Income reported per tax return in 1933, the depth of the Great Depression, was only 48.7% of that in 1929. By 1937, income reported per return was still only 51.4% of that in 1929. Nonfarm unemployment reached a high of 36.3% in 1933, and by 1937 was still 25.4%. U.S. Bureau of the Census, Historical Statistics of the U.S., Colonial Times to 1970, H.R. Doc. No. 78, 93rd Cong., 1st Sess., 126, 1110 (1975).

through general obligation bonds, municipalities turned more to revenue bonds, repayment of which was to come from the revenue produced by the enterprise that the bonds funded. *Id.* But revenue from low-rent housing projects was both limited and insecure.

In order to remedy these unprecedented problems Congress adopted unprecedented solutions. *See* Housing Act § 1. The Housing Act created the United States Housing Authority (USHA), which could borrow money under Section 20(a). This borrowing would be guaranteed by the federal treasury. *Id.* § 20(c). The proceeds of the USHA's borrowing would be lent to local public housing agencies for low-rent housing or slum clearance projects. The maximum amount of the loan, however, would generally be only 90% of the cost of the project. *Id.* § 9. The other 10% would generally be raised by the borrowing of the local housing agency. Tretter, *supra*, at 1336 n. 40.

Since Congress did not guarantee the debts of the local housing authorities, as it did for the USHA in Section 20(c), and since Congress could not exempt that borrowing from state and local taxation, as it did for the USHA in Section 20(b), Congress provided an alternative incentive for the private sector to invest in low-rent housing -- an exemption "from all taxation now or hereafter imposed by the United States." Housing Act §5(e). Vinton Speech, *supra*. That incentive was a logical reaction to a critical problem of the Depression -- unsafe, unsanitary, and inadequate housing.

The reaction of a different Congress to the *Haffner* decision was reasonable in 1984. Conditions then were not

the same as those in 1937. Not only was housing out of its crisis, but public housing authorities in 1984 could more easily raise funds by selling bonds which were exempt only from income tax, because the income tax in 1984 was more important, vis-à-vis the estate tax, than it was in 1937.[17] The 98th Congress' intentions in enacting the Deficit Reduction Act in 1984, however, do not provide any basis for ignoring the 75th Congress' unambiguous intentions 47 years earlier in enacting an exemption from transfer taxes for Project Notes in the Housing Act.

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[17] In 1937, estate and gift taxes collected were $265,745,000, or 24% as much as individual income taxes collected. 2 U.S. Bureau of the Census, *supra* n. 16, at 1106. In 1984, however, estate and gift taxes were only 2% as much as individual income taxes collected. Internal Revenue Service, *Annual Report of the Commissioner and Chief Counsel 10* (1984).

CONCLUSION

Because the plain meaning of the Housing Act of 1937 shows that Congress intended that Project Notes be exempt from transfer taxes, and the legislative history of the Act confirms that intention, the judgment of the court below that Project Notes transferred before June 19, 1984, are exempt from estate and gift taxes should be affirmed.

Respectfully submitted,

Daniel Joseph, P.C.*
Jerry E. Rothrock
Bob C. Griffo
W. Thomas Reeder, Jr.
AKIN, GUMP, STRAUSS, HAUER & FELD
1333 New Hampshire Ave., N.W.
Suite 400
Washington, D.C. 20036
(202) 887-4000

*Counsel of Record

APPENDIX

APPENDIX

AMERICAN FEDERATION
of
HOUSING AUTHORITIES, INC.

SUMMARY REPORT
of
CONFERENCE OF SEPTEMBER 24-25, 1937

The conference was held at the office of the Federation at the Hay-Adams House, 730 Jackson Place, Washington, D.C.

The conference was called to order by Hon. Langdon W. Post, President of the Federation, and the following State Housing Boards and Municipal Housing Authorities answered the roll call:

State	City, Authority, Board	Representatives
California	Los Angeles Municipal Housing Comm.	Walter Wright Alley
Connecticut	Bridgeport Housing Authority	Proxy

Delaware	Delaware State Board of Housing	Lawrence V. Smith
Florida	Miami Housing Authority	Col. S.C. Coe
	Jacksonville Housing Authority	J. S. McMullen
Kentucky	Louisville Municipal Housing Commission	H.W. Alexandria, & A.J. Stewart
Maryland	Annapolis Housing Authority	J. dePeyster Douw
	Baltimore Housing Authority	Herbert Fallin
	Maryland Emergency Housing & Park Commission	Hon. C.W. Perkins
Massachusetts	Boston Housing Authority	George Greene
	Cambridge Housing Authority	Henry Wise
	Massachusetts State Board of Housing	Hon. John Carroll
Michigan	Detroit Housing Commission	Josephine Gomon A. J. Rathnow B. V. Gamber
New Jersey	State Housing Authority	Fred Ehrlich Harry I. Luftman Harry Tupper

New York State	N. Y. City Housing Authority	Langdon Post Mary K. Simkhovitch Charles Abrams

New York State	Schenectady Housing Authority	Miles R. Frisbie
" " "	Syracuse Housing Authority	Sergei N. Grimm
" " "	Yonkers Housing Authority	Matthew F. Kelly T. T. McCrosky
Ohio	Cincinnati Metropolitan Housing Authority	Stanley M. Rowe Bleecker Marquette
"	Columbus Metropolitan Housing Authority	O. A. Corzilius
"	Toledo Metropolitan Housing Authority	C. F. Weiler
Pennsylvania	Pennsylvania State Board of Housing	Hon. George E. Evans
"	City of Pittsburgh	Hon. Cornelius D. Scully Mayor
"	Pittsburgh Housing Authority	Hon. George E. Evans
"	City of Philadelphia	Hon. Prentice E. Edrington

"	Philadelphia Housing Authority	John McShain
"	City of Chester	Henry Gouley
Tennessee	Memphis Housing Authority	Walk C. Jones Dr. L. M. Graves
Washington, D.C.	Paul V. Betters, Executive Director, United States Conference of Mayors	

SESSIONS OF FRIDAY, SEPTEMBER 24

President Langdon Post called attention to the calling of the roll, which was not by individuals but by states and cities, as membership in the Federation is a membership of State Housing Boards and of Municipal Housing Authorities. Federal agencies are not eligible for membership. The Federation he explained also is supported by public funds of the cities and states, and thus is able to represent directly in negotiations with Federal agencies the viewpoint of the cities and the states. All the officers of the Federation are connected with City Housing Authorities. The Federation thus is the local authorities' and State Boards' instrument, through which a common viewpoint is developed coordinated effort organized and the aims of the local agencies expressed to the Congress and the Federal Agencies. It provides the Government on the other hand with a responsible agency of the cities to which it may turn for counsel and advice. The Federation enjoys the confidence and respect of the Government and of the Press.

The purposes for which the Federation is organized are:

1. To protect and perfect the United States Housing Law of 1937.
2. To render legal and other services to its members in the course of their negotiations and dealings with the United States Housing Authority and other governmental agencies.

3. To cooperate and advise with the United States Housing Authority as to its interpretation of the U.S. Housing Law of 1937, its policies, procedure and standards, for the purpose of expediting the successful functioning of the Law and to assure harmonious relations between the United States Housing Authority and the Local Housing Authorities.
4. To exchange information among the members of the American Federation of Housing Authorities relative to the development and administration of projects.
5. To cooperate with all agencies in the promotion of a general housing program.

One of the most important functions of the Federation is to protect the law against unfriendly amendments. The opposition to low-rent public housing is not dead. Some one must protect the bill, and no other agency can do this so effectively as the Federation.

The Federation also is the best means for the creation of nation wide public support for this program. It gathers the news from all the Authorities and relays to the press. This is a vital function.

As the Authorities present their projects and start to execute them, their experience will show that some changes in the law are necessary. The Federation will prepare such amendments and present them to the Congress.

The Washington offices of the Federation will be the Washington office of all its member authorities and state Boards where the staff will watch alertly each city's project and keep after the U.S. Housing Authority, expediting the progress of these projects and maintaining cordial relations between the Government and the cities.

This will result in great savings to all our members. To get a single project through the Housing Division, before the Federation was organized required months, sometimes years, and cost authorities and cities usually thousands of dollars in traveling expenses, unnecessary research and long distance telephone calls.

The cost of membership in the Federation will be saved by an Authority, probably in one month.

Then there is the matter of administrative regulations. The Federation must be consulted with respect to these, reporting back to the local authorities, obtaining their views, and making sure that proposed regulations will work effectively and without delaying projects or causing needless expense.

All this calls for a national organization such as this, ready to fight when it is necessary for the views and the cities.

It is not that the Government means to be unfair, but Washington is a long way from home and even the largest City in the land looks mighty small and lonesome when by itself it faces the United States Government.

If we did not have a Federation, we should have to create one.

But here it is, established by the Authorities, supported by the Authorities, working for the Authorities, and proven effective by its success in having the law enacted, through the fine support you gave us.

The Federation welcomes the existence of the social and other housing agencies and will cooperate with them. There is a big job for them to do, as there is for the Federation.

The By-Laws of the Federation were then adopted by a unanimous vote. (Copy of the By-Laws attached).

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SUMMARY OF ADDRESS OF
MR. WARREN VINTON

I am happy to say that the vital parts of the Wagner Bill were not removed. A permanent housing program has been set up. The Federal Government is making loans to local Authorites for the building of projects and is making annual subsidies and contracting for them; contracting in advance for the payment of subsidizing something is absolutely unique in this country, something the supporters of the Bill hesitated about before they proposed it. Last year, 1936, although the annual subsidy was recognized as a superior form of subsidy, we didn't dare go for it. This year we got a little more nerve and went for it and got it.

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The getting of these loans will depend upon whether the Federal Government is able to take and willing to take - not able, but willing - a second mortgage position on its 90 per cent loan. The city and state conveivably, if they made loans to a project, could themselves take the second mortgage

position, but private money would certainly insist on the first mortgage position. I see nothing in the Bill that would justify the Federal Government to take the second mortgage position. The Bill as originally drafted permitted the Federal Government to take the second mortgage position. The real estate minded members of the House Committee, inserted a first mortgage position and receded from that in conference, so that the Congress had definitely before it the quetion of whether or not these should be first mortgage loans and did not make that requirement, therefore I believe the Federal Government is justified in taking the second mortgage position. If it does that an authority certainly can borrow private funds of 10, and I believe 20 or 30 per cent, without difficulty.

Mind you the obligations of the local Authorities - and a mortgage bond is an obligation of local Authority - are exempt from all Federal taxes, not only normal income taxes but surtax, inheritance tax, and gift tax. Investments of that nature are getting rare in the country. They are at a premium. The mortgage obligation of the local Authorities ought to command a ready market. I should hope that as soon as investors are used to that form of obligation you ought to borrow money for three to three-and one-half per cent.

If you only want your 10 per cent from private funds, private funds are amply secured. There is no provision in the Bill which would restrict them from getting a first lien on the revenues of the project other than the annual subsidies. The annual subsidies are, by the terms of the Bill, mortgaged to the Federal Government in repayment of its loan, but all other

rents and incomes from the property could be applied and given as security for the payment of the private loans.

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AMICUS CURIAE

BRIEF

Supreme Court, U.S.
FILED
OCT 28 1987
JOSEPH F. SPANIOL, JR.
CLERK

No. 86-1521

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

UNITED STATES OF AMERICA,

Appellant,

v.

WELLS FARGO BANK, *ET AL.*,

Appellees.

UNITED STATES OF AMERICA,

Appellant,

v.

HARRY ROSENBERG AND ARTHUR ROSEN, *ETC.*,

Appellees.

On Appeal from the United States District Court for the Central District of California

BRIEF OF THE EXECUTORS OF THE ESTATE OF MARION DU PONT SCOTT, AS *AMICI CURIAE*

JAMES J. CARROLL*
HOLLY A. HARRISON
GERARD D. KELLY
Sidley & Austin
One First National Plaza
Chicago, Illinois 60603
(312) 853-7000

ATWELL W. SOMERVILLE
Somerville, Moore & Somerville
Sovran Bank Building
Post Office Box 629
Orange, Virginia 22960
(703) 672-3200

Counsel for Amici Curiae
*Counsel of Record

QUESTIONS PRESENTED

Did § 641 of the Deficit Reduction Act of 1984, which was enacted more than two years after the deaths of the decedents in the instant case, cut off their executors' estate tax refund claims. More specifically:

(a) Should § 641 be interpreted to apply retroactively to estates (such as decedents' in this case) for which federal estate tax returns were filed before its effective date provision; and

(b) If § 641 is interpreted retroactively, does such retroactive application offend the fifth amendment.

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On Appeal from the United States District Court for the Central District of California

BRIEF OF THE EXECUTORS OF THE ESTATE OF MARION DU PONT SCOTT, AS *AMICI CURIAE* IN SUPPORT OF APPELLEES

The *amici curiae*, V.R. Shackelford, Jr., William du Pont III and David C. Rittenhouse, as executors of the estate of Marion du Pont Scott, submit this brief in support of the appellees.[1]

INTEREST OF AMICI CURIAE

The *amici curiae*, V.R. Shackelford, Jr., William du Pont III and David C. Rittenhouse, as executors of the estate of Marion du

[1] The letters in which each of the parties have consented to the filing of this brief are filed contemporaneously herewith pursuant to Rule 36.2.

Pont Scott, are the plaintiffs in an estate tax refund suit similar to the instant case. *Shackelford* v. *United States*, 649 F. Supp. 1347 (E.D. Va. 1986). On March 28, 1986, the *amici curiae* (referred to herein as the "*Shackelford* executors") instituted a suit in the United States District Court for the Eastern District of Virginia for the refund of estate taxes erroneously paid with respect to tax-exempt Project Notes.[2] The district court denied the *Shackelford* executors' motion for summary judgment and entered judgment in the government's favor. The *Shackelford* executors appealed the decision to the United States Court of Appeals for the Fourth Circuit. *Shackelford* v. *United States*, No. 87-2512 (4th Cir.). Shortly after the *Shackelford* executors filed their initial brief, the Fourth Circuit stayed the appeal upon the government's motion, pending a decision by this Court in the present case.

The issues presented in *Shackelford* v. *United States* are similar to the issues in the instant action: (1) whether § 11(b) of the United States Housing Act of 1937 ("Housing Act"), 42 U.S.C. § 1437i(b), exempts Project Notes from estate taxation; and (2) whether § 641(b)(2) of the Deficit Reduction Act of 1984 ("DEFRA"), Pub. L. No. 98-369, 98 Stat. 434, properly can be construed to abrogate that tax exemption. The interests of the *Shackelford* executors are identical to those of the appellees regarding the first issue. However, with respect to the constitutionality of a retroactive application of § 641, the reliance interests of the *Shackelford* executors differ from the reliance interests of the appellees here. Therefore, the focus of the *Shackelford* executors' constitutional arguments on the second issue is not the same as that of the appellees.

Since the Court's decision in the instant case could be controlling in the *Shackelford* case, the *Shackelford* executors are concerned that, in determining the constitutionality of § 641 of

[2] The Department of Housing and Urban Development discontinued the issuance of Project Notes in 1984, and no Project Notes are now outstanding.

DEFRA, the Court be fully apprised of all relevant taxpayer reliance interests that may be affected by the statute. The taxpayers in the instant case have emphasized that a retroactive construction of § 641 would defeat the reliance interests of their *decedents*. The *Shackelford* case, however, illustrates another dimension of taxpayer reliance interests — the justified reliance of *executors* in their vested right to prosecute a refund claim under the Internal Revenue Code.

The *Shackelford* executors submit that a retroactive construction of § 641 would impermissibly defeat not only their decedent's reliance interests, but also their own reliance interests in the long-standing statutory scheme for obtaining tax refunds. Since the alleged application of § 641 was triggered by conduct of the executors, it is appropriate that their reliance interests be given equal consideration in assessing the constitutionality of the statute.

In its brief, the government asserts that § 641 "upsets no settled expectations. . . ." Govt. Br. p. 39. The government further contends that Congress limited § 641's retroactive effect to ensure "that DEFRA would not operate retroactively against any taxpayer who might reasonably be thought to have acted in reliance on the assumption that Project Notes were exempt from transfer tax." Govt. Br. p. 45. The facts of the *Shackelford* case conclusively prove the government wrong on both points. Indeed, in *Shackelford*, the government stipulated that the *Shackelford* executors had filed their federal estate tax return with knowledge of the tax exemption for Project Notes and in reliance on their right to later pursue their statutory refund rights. The *Shackelford* executors would never have included their decedent's Project Notes in their estate tax return had they been given notice that § 641 would foreclose their right to file for a refund.

The *Shackelford* executors also wish to bring to the attention of the Court other arguments on the construction and constitutionality of § 641 that may not be made by the appellees. So that

the Court may understand the taxpayer reliance interests at issue in *Shackelford*, the following is a brief statement of the pertinent facts of that case.

The decedent in the *Shackelford* case died on September 4, 1983.[1] At the time of her death, her estate consisted primarily of tax-exempt Project Notes. When the *Shackelford* executors filed the return, on May 31, 1984, they were aware that § 11(b) of the Housing Act had been construed to exempt Project Notes from federal estate tax.

However, the *Shackelford* executors also knew that the government had adopted the position that § 11(b) did not confer an estate tax exemption. On February 23, 1981, the Internal Revenue Service ("IRS") had issued Revenue Ruling 81-63, 1981-1 C.B. 455. In that ruling, the IRS had for the first time taken the position that the tax exemption in § 11(b) of the Housing Act did not include estate taxes. The *Shackelford* executors further realized that, in view of the IRS's position, the government would probably appeal the decision of the United States District Court for the Northern District of Illinois in *Haffner* v. *United States*, 585 F. Supp. 354 (N.D. Ill. 1984), *aff'd*, 757 F.2d 920 (7th Cir. 1985) (*per curiam*), which held that the transfer of Project Notes is exempt from tax under § 11(b). That decision had been rendered by the *Haffner* district court on April 25, 1984, five weeks before the federal estate tax return in *Shackelford* was due.

The *Shackelford* executors knew that if they paid no estate tax on the Project Notes and the *Haffner* decision were later reversed on appeal, the estate would be subject to high interest assessments (then 11% compounded daily) as well as possible penalties. Their return was due on June 4, 1984, long before an appellate decision in the *Haffner* case could be rendered. The *Shackelford* executors also knew that, (1) under 26 U.S.C. § 6511(a) they were entitled

[1] The government has stipulated in the *Shackelford* case to the facts described herein.

to file a claim for refund of any overpayment of estate taxes within three years of filing the decedent's estate tax return, (2) under 26 U.S.C. § 7422(b) they were not required to pay estate tax "under protest" in order to preserve their refund claim, and (3) under 26 U.S.C. § 6611 the estate would be entitled to interest on any overpayment subsequently refunded.

In reliance on these provisions of the Internal Revenue Code, the *Shackelford* executors determined that the prudent course was to report the Project Notes on the decedent's estate tax return and to await the outcome of the *Haffner* appeal. Accordingly, on May 31, 1984, they filed an estate tax return listing the Project Notes as part of the taxable estate. Relying on their right to recover any overpayment, they deposited $30,337,094 in federal estate taxes, $22,532,904 of which is attributable to the decedent's Project Notes.

On June 22, 1984, 22 days after the *Shackelford* executors filed their return, the conferees of the House of Representatives and Senate approved DEFRA. The DEFRA bill included § 641, a provision purporting to be a "Clarification of Treatment of Certain Exemptions for Purposes of the Federal Estate and Gift Taxes." As discussed in detail below, § 641 contains a mandatory rule of statutory construction requiring the courts to construe any statutory exemption from taxation to exclude an exemption from federal estate, gift, and generation-skipping transfer taxes. Subsection (b)(2) provides that the rule is to apply "in the case of any transfer of property (or interest therein) if at any time there was filed an estate or gift tax return showing such transfer as subject to Federal estate or gift tax." The government has stipulated that, at the time the *Shackelford* executors filed their return on May 31, 1984, they had no notice, either actual or constructive, that there was any legislation under consideration that would have impaired their right to claim an estate tax refund.[2]

[2] The text of § 641 first appeared in the *Congressional Record* dated June 22, 1984 (130 Cong. Rec. 6495).

After the district court's decision in *Haffner* was affirmed by the Seventh Circuit and the government's time to seek review by this Court of that decision had expired, the *Shackelford* executors initiated refund proceedings in accordance with their plan at the time they filed the return. As discussed above, the United States District Court for the Eastern District of Virginia denied their refund suit, and their appeal is being held in abeyance in the Fourth Circuit pending the outcome of the instant case.

The *Shackelford* executors adopt the argument of the taxpayers in this case that § 11(b) of the Housing Act exempts Project Notes from estate taxation and, accordingly, will not present argument on that issue. This *amici curiae* brief will address itself exclusively to the question of whether § 641 may properly be applied to the *Shackelford* executors and other similarly-situated taxpayers who, prior to the enactment of DEFRA, filed an estate tax return treating Project Notes as taxable with full knowledge of the tax exemption and in express reliance on their right subsequently to seek a refund of taxes overpaid.

SUMMARY OF ARGUMENT

Section 641(b)(2) of DEFRA cannot properly be interpreted to operate retroactively. Statutes are to be interpreted retroactively only where such an intention is "clearly declared." *Schwab* v. *Doyle*, 258 U.S. 529 (1922). The language of § 641(b)(2) upon which the government bases its argument for retroactive application has been interpreted by this Court to apply prospectively only. *Hassett* v. *Welch*, 303 U.S. 303 (1938). In addition, nothing in the legislative history of § 641(b)(2) supports a retroactive interpretation. Where Congress intended provisions of DEFRA to apply retroactively, it used language clearly declaring such a retroactive effect. *See, e.g.*, DEFRA § 2662(g). Moreover, given the doubtful constitutionality of a retroactive application of

§ 641(b)(2), this Court should adopt a prospective interpretation that would avoid difficult constitutional inquiries. *United States* v. *Security Industrial Bank*, 459 U.S. 70 (1982).

If construed to apply retroactively, § 641(b)(2) should be struck down as a violation of the doctrine of separation of powers. Subsection (b)(2) by its own terms is a mandatory rule of construction, not a repeal of the Housing Act's estate tax exemption on the transfer of Project Notes. The subsection requires courts to construe certain statutory language in a particular way, thus preventing the courts from performing their fundamental adjudicatory function to determine what Congress actually intended when it enacted the original statute. Even if the retroactive revocation of executors' rights to obtain a refund were constitutional, the method chosen in § 641(b)(2) — a broad rule of decision — is constitutionally infirm.

If applied retroactively, § 641(b)(2), would violate the fifth amendment. First, it would violate the due process rights of executors who, in reporting Project Notes on their estate tax returns, have relied to their detriment on their right to obtain an estate tax refund. Retroactive laws are scrutinized more closely than prospective laws. Under the applicable constitutional analysis, a retroactive application of § 641(b)(2) would violate due process, because it would give a more oppressive effect to irrevocable pre-enactment conduct undertaken by both the decedents and their executors. The government's contention that § 641 "upsets no settled expectations" is simply wrong. The government has previously admitted facts demonstrating that § 641 upset the settled expectations of the *Shackelford* executors by revoking without notice the right to a refund upon which they justifiably relied. Section 641(b)(2) also impermissibly shortened the statute of limitations for filing a refund claim under 26 U.S.C. § 6811; this action cannot constitutionally be taken without prior notice. *Ochoa* v. *Hernandez y Morales*, 230 U.S. 139 (1913).

Second, the retroactive revocation of the rights of executors to obtain a refund constitutes a confiscation of property for which such executors have not been justly compensated. Accordingly, § 641, retroactively applied, constitutes an unlawful taking in violation of the fifth amendment.

This Court should therefore interpret § 641 so as to avoid raising difficult constitutional questions, or, alternatively, it must strike down § 641 as violative of the fifth amendment.

ARGUMENT

I. Section 641 of the Deficit Reduction Act Should Not Be Interpreted to Bar Refund Claims Based on Estate Tax Returns Filed Before Its Effective Date

Section 641(b)(2), properly interpreted, applies to gifts made and decedents dying *before* the provision's effective date, but only if a gift or estate tax return was filed *after* that date. Contrary to the government's contention, § 641(b)(2) does not operate retroactively to bar the refund claims of taxpayers such as appellees and the *Shackelford* executors. Under firmly-established principles of statutory construction, if a statute may reasonably be interpreted to operate prospectively only, it must be so interpreted absent a strong indication of Congressional intent to the contrary. *Schwab*, 258 U.S. 535-36. The language of § 641 itself does not contain a sufficient declaration of such intent by Congress. Furthermore, the legislative history of DEFRA provides no indication whatsoever that Congress intended § 641(b)(2) to have retroactive effect. Accordingly, a prospective interpretation of § 641(b)(2) is mandated.

Section 641 of DEFRA contains a substantive rule of statutory construction – subsection (a) – and two distinct effective date provisions – subsections (b)(1) and (b)(2). Subsection (b)(1) applies the substantive provision of § 641 to "the estates of decedents dying, gifts made, and transfers made on or after June

19, 1984." Thus, this effective date provision focuses on the date the pertinent transfer was made. It is not disputed that § 641(b)(1), which is prospective in nature, is inapplicable to the taxpayers in the present case as well as the *Shackelford* case, since their decedents all died prior to June 19, 1984.

It is subsection (b)(2) that the government contends bars the taxpayers' present refund claims. Subsection (b)(2) reads:

> TREATMENT OF CERTAIN TRANSFERS TREATED AS TAXABLE. The provisions of subsection (a) shall also apply in the case of any transfer of property (or interest therein) if at any time there was filed an estate or gift tax return showing such transfer as subject to Federal estate or gift tax.

Under the government's construction of § 641(b)(2), the phrase "at any time" renders the provision retroactive, so as to bar refund claims made by executors who had filed estate tax returns treating the Notes as taxable *before* the June 19, 1984, effective date.

This Court has held that a statute will not be construed to apply to transactions which occurred before its passage unless that intention has been "clearly declared." *Schwab*, 258 U.S. at 534. " '[R]etrospective laws are, indeed, generally unjust; and, as has been forcibly said, neither accord with sound legislation nor with the fundamental principles of the social compact.' " *Schwab*, 258 U.S. at 534, quoting Story, const., § 1398. Accordingly, this Court has consistently presumed that a statute operates prospectively only, unless "a clear, strong and imperative" declaration of retroactivity appears on the face of the statute itself. *Schwab*, 258 U.S. at 535-36; *see also Hassett* v. *Welch*, 303 U.S. 303, 314 (1938); *United States* v. *Burr*, 159 U.S. 78, 82-83 (1895); *United States* v. *Heth*, 7 U.S. (3 Cranch) 398, 413 (1806).

The government relies on the words "at any time" to support its argument that Congress intended § 641(b)(2) to apply retroactively. Contrary to the government's suggestion, this language does not constitute the essential "clear, strong, and imperative"

declaration of retroactivity. The argument is in fact foreclosed by decisions of this Court holding that identical language in other tax-related statutes could not be interpreted to apply to pre-enactment transfers of property. *Hassett*, 303 U.S. 303; *Union Trust Co. v. Wardell*, 258 U.S. 537 (1922); *Schwab*, 258 U.S. 529.

In *Hassett*, for example, this Court held that § 302(c) of the Revenue Act of 1926, as amended (47 Stat. 169, 279), did not impose a tax on transfers made before the effective date of the amendment. *Hassett*, 303 U.S. 303. The amended § 302(c) imposed estate tax on property "of which the decedent has *at any time* made a transfer, by trust or otherwise, in contemplation of or intended to take effect in possession or enjoyment at or after his death. . . ." *Hassett*, 303 U.S. at 308 (*quoting* § 302(c), as amended) (emphasis added). As here, the attempt to alter the effect of the statute was done hastily in response to a judicial decision, and the "legislative history [was] . . . bare of any indication of any purpose that it should affect past transfers." *Id.* at 309, 312.[7] The government seized on the phrase "at any time" as evidence that Congress intended the amendment to apply to irrevocable trusts created prior to its enactment, contending that this language was "so unequivocal as to leave no room for construction." *Id.* at 308. The Court, however, rejected the government's argument, observing that the identical phrase appearing in an earlier revenue act had been held not to apply to transfers made prior to enactment. *Id.* at 308; *see Schwab*, 258 U.S. 529; *Union Trust*, 258 U.S. 537.

Under the rule enunciated in *Hassett*, therefore, the government can point to no language on the face of § 641(b)(2) constituting a clear, strong and imperative declaration of retroactivity. Accordingly, the provision must be presumed to apply prospectively only, unless a contrary intent is clearly manifested in § 641's legislative history. *See Schwab*, 258 U.S. at 535.

[7] In *Hassett*, the amendment was drafted within one day of its passage. *Hassett*, 303 U.S. at 309-310. Here, § 641 was tacked onto DEFRA in the Conference Committee just before it was reported to the Congress on June 22, 1984.

Because the legislative history of § 641 is also devoid of any indication that Congress intended a retroactive application, the government's argument must fail. The legislative history of § 641 is sparse, at best.[8] Like the provision reviewed in *Hassett*, § 641 was hastily enacted in response to a judicial decision, and added to DEFRA only days before its presentation to the Senate. Congress's complete silence on this issue of retroactivity manifestly cannot be viewed as a declaration, let alone an unequivocal one, of its intent that § 641 should have retroactive application.[9]

Moreover, an examination of other provisions of DEFRA clearly demonstrate that Congress knew what language to employ to accomplish retroactive operation. In § 2662(g) of DEFRA, Congress amended the 1983 Social Security Amendments as follows: "The amendments made by subsection (b) and subsection (c)(4) shall apply to remuneration . . . paid after March 4, 1983, *and to any such remuneration paid on or before such date which the employer treated as wages when paid.*" (emphasis added). In sharp contrast, § 641(b)(2) contains no unambiguous statement regarding the effect of *pre-enactment* transactions. As the Court noted in *Schwab*, if Congress intends to make a statute retroactive in effect, Congress should be required to declare it unambiguously, since, "when it had that purpose, it did declare it." *Schwab*, 258 U.S. at 536.

[8] In fact, § 641 is not specificaliy discussed anywhere in the *Congressional Record*. 130 Cong. Rec. 58372-58422 and H7128 (Daily Ed. June 27, 1984).

[9] The government erroneously relies on statements contained in the *General Explanation of the Revenue Provision of the Deficit Reduction Act of 1984* of the Joint Committee on Taxation issued six months after the passage of DEFRA. However, under the Treasury Regulations, "descriptions of statutes prepared after enactment (*such as 'General Explanations' prepared by the Staff of the Joint Committee on Taxation*) . . . *are not authority*." 26 C.F.R. § 1.6661-3(b)(2) (emphasis added). Moreover, the original report, issued contemporaneously, contained no reference whatsoever to any intended retroactive effect.

It is of no significance whatsoever that § 641(b)(2) might reasonably be construed to apply retroactively, or even that a retroactive construction would seem more reasonable than a prospective one. If the absence of a clear declaration of retroactivity "leaves to the statute a double sense, *it is the command of the cases, that that which rejects retroactive operation must be selected.*" *Schwab*, 258 U.S. at 535 (emphasis added). Accordingly, if the statute may rationally be construed to operate prospectively only, that construction must be adopted.

It is manifest that § 641 can reasonably be construed to operate prospectively. Section 641(b) contains two effective date provisions, both of which, although triggered by different events, were intended to be operative as of June 19, 1984. Subsection (b)(1) delineates the effective date with reference to the date of the taxable event — either an *inter vivos* gift or a death occurring on or after June 19, 1984. By contrast, subsection (b)(2) focuses on the time of filing by an executor or donor of an estate or gift tax return. Construing subsection (b)(2) prospectively would apply § 641's substantive provisions to transfers made or decedents dying prior to June 19, 1984,* if at any time after the effective date of § 641, there was filed a tax return treating the transfer as taxable.

It is also apparent that a prospective interpretation of subsection (b)(2) clearly would not render that subsection "a dead letter," as the government contends. Govt. Br. p. 37 n. 20. Because an executor has nine months from the date of the decedent's death to file an estate tax return, many estates that did not fall within the purview of subsection (b)(1) could be covered by subsection (b)(2) (namely, those estates where the decedent died after September 18, 1983, so that the estate tax return was due after June 18, 1984). Subsection (b)(2) would deny an estate tax exemption to those estates if *after* June 18, 1984 an executor elected to file an estate tax return showing the Notes as taxable.

*This date approximately coincided with the date § 641 was first considered by Congress.

This construction of subsection (b)(2) is not only reasonable, it is also logically compelling. It is apparent from the language of § 641 that Congress fashioned the effective date provisions to revoke a transfer tax exemption for housing obligations as of a particular date. Subsection (b)(1) therefore stated that the provision would apply prospectively to all gifts made or decedents dying after this date. This subsection, however, did not cover those situations in which the decedent had died prior to that date but for whom no estate tax return had yet been filed. The executors of such an estate could be presumed to have knowledge of § 641 as of the date the provision was first considered by Congress. Thus, properly construed, § 641 uniformly applies to those executors and donors who could be charged with notice of the provision, while at the same time preserving rights that had already vested by virtue of the filing of an estate tax return prior to the time such notice was given.

A prospective construction of § 641(b)(2) is further supported by other decisions of the Court holding that a statute "is to be construed, if such a construction is fairly possible, to avoid raising doubts of its constitutionality." *St. Martin Evangelical Lutheran Church* v. *South Dakota*, 451 U.S. 772, 780 (1981); *see also Lynch* v. *Overholser*, 369 U.S. 705, 710-711 (1962). A court should " 'decline to construe the Act in a manner that could in turn call upon the Court to resolve difficult and sensitive [constitutional] questions.' " *United States* v. *Security Industrial Bank*, 459 U.S. 70, 82 (1982) (quoting *NLRB* v. *Catholic Bishop of Chicago*, 440 U.S. 490, 507 (1979)). As discussed in the following sections of this brief, a retrospective construction of subsection (b)(2) would be replete with constitutional infirmities.

The *Shackelford* executors therefore urge this Court to interpret subsection (b)(2) so that it applies prospectively to tax returns filed on or after June 19, 1984. Such a construction would pass constitutional muster because all executors and donors filing estate or gift tax returns after the effective date, unlike taxpayers

in the instant case and the *Shackelford* case, would have had constructive — if not actual — notice that the inclusion of their Project Notes in the tax return would preclude the filing of a subsequent refund claim. The inclusion of such Notes in an estate or gift tax return on or after June 19, 1984 would therefore constitute a knowing waiver of a refund claim based on § 11(b).

II. Section 641 Violates Principles of Separation of Powers by Imposing a Mandatory Rule of Statutory Construction on the Courts

Even if the Court finds that Congress intended § 641(b)(2) to apply retroactively to the taxpayers in this case, it should nevertheless decline to apply it in such a fashion. Section 641, as enacted by Congress, is a mandatory rule of statutory construction that attempts to usurp the most fundamental function of the judiciary — to interpret the law. Because it violates the well-recognized principles of separation of powers, this Court should not allow it to stand.

Section 641, which purports to be clarifying legislation, states that "[n]othing in any provision of law exempting any property (or interest therein) from taxation shall exempt the transfer of such property (or interest therein) from Federal estate, gift, and generation-skipping transfer taxes." Subsection (b)(2) declares that the above-stated "general rule" is effective as to transfers made on or after June 19, 1984, and as to "any transfer of property (or interest therein) if at any time there was filed an estate or gift tax return showing such transfers as subject to Federal estate or gift tax." Significantly, § 641 does not purport to repeal the tax exemption of § 11(b) of the Housing Act. Indeed, it makes no reference whatsoever to the Housing Act or any other legislation. Instead, it imposes a mandatory rule of statutory construction upon the judiciary to be applied to all previously-enacted legislation without regard to Congress's actual intent. Section 641, therefore, usurps the inherently judicial function to say what the law is. *See Marbury* v. *Madison*, 5 U.S. (1 Cranch) 137, 176 (1803).

The doctrine of separation of powers ensures the integrity of the three branches of our government by requiring that each coordinate branch function independently. This Court has not hesitated to maintain the separation of powers by striking down statutes whereby Congress "has inadvertently passed the limit which separates the legislative from the judicial power." *United States* v. *Klein*, 80 U.S. (13 Wall.) 128, 147 (1872). The permissible boundaries are overstepped where, as in § 641, Congress has attempted to prevent the courts from exercising their adjudicatory function. *See United States* v. *Sioux Nation of Indians*, 448 U.S. 371, 404 (1980).

It is well settled under the doctrine of separation of powers that Congress may not dictate a rule of decision which leaves the courts no adjudicatory function to perform. *Sioux Nation*, 448 U.S. at 404-05, citing *United States* v. *Klein*, 80 U.S. (13 Wall.) at 146. "The interpretation of the laws is the proper and peculiar province of the courts." *The Federalist*, No. LXXVIII, p. 101; *see also Marbury*, 5 U.S. (1 Cranch) at 176. Thus, the courts alone are empowered to interpret the meaning and scope of an act of Congress.

Applying these principles, this Court struck down a Congressional enactment in *United States* v. *Klein*, 80 U.S. (13 Wall.) at 128, as a violation of the separation of powers doctrine. The enactment in question attempted to avoid the effect of a prior decision of this Court holding that a presidential pardon purged an individual "of whatever offense against the laws of the United States he had committed . . . and relieved [him] from any penalty which he might have incurred." *Id.* at 143-44, *citing United States* v. *Padelford*, 76 U.S. (9 Wall.) 531, 543 (1870). Congress responded by enacting a proviso to the appropriations bill for the Court of Claims that provided in pertinent part that, in certain property claims actions, the Court of Claims was to treat the claimant's receipt of a presidential pardon as evidence of the offense for which the pardon had been issued, the effect of which

would have been to deprive the claimant of his cause. *United States* v. *Klein*, 80 U.S. (13 Wall.) at 144.

The Court rejected Congress's attempt to prescribe a rule of decision in a manner that would require the court to decide a controversy in the government's favor:

> Can [Congress] prescribe a rule in conformity with which the court must deny to itself the jurisdiction thus conferred, because and only because its decision, in accordance with settled law, must be adverse to the government and favorable to the suitor? This question seems to us to answer itself.

United States v. *Klein*, 80 U.S. (13 Wall.) at 146-147. The continuing vitality of the holding of *United States* v. *Klein* was recently acknowledged by this Court in *Sioux Nation*, 448 U.S. at 403-405.

It is apparent that § 641 is similarly repugnant to the doctrine of separation of powers. Section 641 conspicuously attempts to prevent the courts from exercising its most fundamental function — to interpret the law. By its own terms, the provision imposes a rule of construction on the judiciary that would require courts to interpret statutory language in a particular way irrespective of Congress's actual intent in enacting the legislation. Indeed, Section 641 would require a court to *ignore* legislative history clearly and unambiguously stating that an estate tax exemption is intended.

The impermissible nature of § 641 is further demonstrated by the fact that it is a rule of general applicability, rather than a rule that applies expressly to the § 11(b) tax exemption. The provision therefore operates only with reference to the judiciary's exercise of its interpretive function, and not with reference to a particular substantive law. As such, § 641 is at odds with prior decisions of this Court recognizing that an exemption from "all taxation," while generally presumed to extend to direct taxes only, will be construed to extend to transfer and other indirect taxes where such congressional intent is manifested in the language or legislative history of the Act.

It is significant that if § 641 is allowed to stand, it will not only affect the courts' interpretation of § 11(b) of the Housing Act, but indeed, it will undercut the fundamental statutory interpretation analysis that has been applied by this Court to construe similar tax exemption provisions. For example, in *American Bank & Trust Company* v. *Dallas County*, 463 U.S. 855 (1983), this Court rejected the State of Texas's argument that an exemption from "[a]ll stocks, bonds, Treasury notes, and other obligations of the United States, shall be exempt from taxation by or under State or municipal or local authority," must not be construed to extend beyond income tax. The state argued that prior decisions of this Court, distinguishing between taxes on property and taxes on transfers of property or discrete property interests, required the Court to limit its construction of the tax exemption to income tax. The Court refused to apply its prior decisions as inviolate rules, but instead, went on to examine the language and legislative history of the statute in question. *Id.* at 862.

It is apparent that an application of § 641 would preclude a court from undertaking the analysis endorsed by this Court in *American Bank*. Where this Court has found that Congress's intent must be considered in construing an exemption from "all taxation," § 641 would require that Congress's manifested intent be ignored.

Because § 641 is in violation of the doctrine of separation of powers, it should be struck down regardless of whether Congress constitutionally could have accomplished the same result through a different form of legislation. Specifically, this Court should not go on to consider whether Congress constitutionally could have retroactively repealed the § 11(b) estate tax exemption. Congress may not achieve an arguably constitutional end through

unconstitutional means. As James Madison observed in *The Federalist*, No. XLVIII, p. 340, the legislature's "constitutional powers being at once more extensive, and less susceptible of precise limits, it can, with the greater facility, mask under complicated and indirect measures, the encroachments which it makes on the coordinate departments." Thus, even if a retroactive repeal of the § 11(b) estate tax exemption were constitutionally permissible, it may not be covertly accomplished through a blatant encroachment on the inherent province of the judiciary.[1]

The constitutionality of § 641 must thus be determined with reference to its explicit terms. Because § 641 presumes to usurp the inherently judicial function of ascertaining the meaning of statutes, it violates the fundamental concepts underlying the doctrine of separation of powers. Accordingly, this Court should refuse to give it effect without regard to whether it could have passed constitutional muster as a retroactive repeal of § 11(b) of the Housing Act.

III. RETROACTIVE APPLICATION OF § 641 WOULD VIOLATE THE FIFTH AMENDMENT

If § 641(b)(2) were construed to apply retroactively to estates for which tax returns were filed prior to June 19, 1984, it would

[1] This principle was recognized by the Court in *United States* v. *Romano*, 382 U.S. 136 (1965). In *Romano*, the Court struck down as unconstitutional a statutorily-created inference that the presence at the site of an illegal still constituted proof of the offense of possession, custody or control of the still. In an attempt to avoid the constitutional infirmities of the statutory inference, the government argued that the provision in question should be viewed merely as an attempt by Congress to broaden the substantive offense of possession of an illegal still to include presence at the site of the still. The government contended that because Congress could constitutionally broaden the substantive offense, the creation of a statutory inference leading to the identical result should be upheld. *Id.* at 142. This Court rejected the government's argument, finding that the constitutionality of the statute in question was to be examined with reference to the means Congress had actually chosen to achieve the desired result—not other arguably permissible means it might have chosen. *Id.* at 144.

violate the taxpayers' constitutional rights by depriving them of their vested right to a refund of estate tax in contravention of the due process clause and by impermissibly taking their refund claims without compensation.

A. Section 641, as Construed by the Government, Is an Unconstitutional Retroactive Statute

The government contends that § 641(b)(2) may constitutionally be applied to preclude the refund claims of the taxpayers in the present case, because retroactive taxing statutes have been previously upheld by this Court. However, retroactive statutes are repugnant to due process where, as here, they give a more oppressive legal effect to irrevocable conduct undertaken prior to their enactment. In arguing that § 641(b)(2) survives constitutional scrutiny, the government erroneously asserts that the taxpayers did not rely to their detriment on the § 11(b) exemption, since "there is no reason to believe that the decedents even considered the possibility of such an exemption. . . ." Govt. Br. p. 41. Contrary to the government's assertion, however, if the § 11(b) exemption from estate tax in fact existed at the time of death, the decedent must be presumed to have known about it. Moreover, as discussed below, the government's argument completely ignores the relevance of the reliance interests of taxpayers, such as the *Shackelford* executors, who have acted in explicit reliance on the existence of the § 11(b) estate tax exemption and on their right to obtain an estate tax refund for taxes paid on Project Notes.

Under the due process clause, the government must give fair notice to an individual before depriving him of a substantive right. *See, e.g., Lynch* v. *United States*, 292 U.S. 571 (1934). Accordingly, because retroactive laws may affect pre-existing rights and conduct, they may have been viewed by this Court with disfavor. *Schwab*, 258 U.S. at 534-35. In *Usery* v. *Turner Elkhorn Mining Co.*, 428 U.S. 1 (1976), the Court noted that although a retroactive law is not by definition violative of due process, "[i]t does not follow that what Congress can legislate prospectively it

can legislate retrospectively." *Id.* at 16. Alluding to a heightened standard of review applied to retroactive statutes, the Court has declared that "[t]he retrospective aspects of legislation, as well as the prospective aspects, must meet the test of due process, *and the justifications for the latter may not suffice for the former.*" *Id.* at 17 (emphasis added).

As a general matter, retroactive laws are violative of due process if they deprive an individual of a vested right. *Ettor* v. *Tacoma*, 228 U.S. 148, 155-156 (1913). A right will be deemed vested if a party has irrevocably acted to his detriment in reliance on it. *Untermeyer* v. *Anderson*, 276 U.S. 440, 445 (1928). Accordingly, if Congress intended to single out taxpayers, such as the *Shackelford* executors, and deprive them of their estate tax refund claim, it would have had to give them sufficient notice of the change in the statutory scheme so that they could adjust their conduct before the law became effective.

The government erroneously suggests that § 641 is immune from the constitutional scrutiny generally applicable to retroactive legislation because it is "tax legislation." Govt. Br. pp. 38-39. Contrary to the government's assertion, although § 641 affects the amount of tax which the taxpayers ultimately will pay, § 641 is not itself a taxing measure. Section 641 does not amend any provision of the Internal Revenue Code. Nor does it amend the Housing Act, which exempted Project Notes from federal tax. Accordingly, § 641 is entitled to no judicial deference as a taxing statute, as the government suggests, but rather should be judged by the same constitutional standards that apply to other retroactive statutes that eliminate vested substantive rights.

Moreover, even if § 641 were to be considered a retroactive taxing measure, it must nevertheless be found to violate the due process clause. The Court has recently recognized in *United States* v. *Hemme*, 106 S. Ct. 2071, 2078 (1986), that the validity of a retroactive tax turns on "whether, without notice, a statute

gives a different, more oppressive legal effect to conduct undertaken before the enactment of the statute." The decisions of this Court analyzing the constitutionality of retroactive transfer taxes have therefore focused on concepts of foreseeability and reasonable reliance. Accordingly, the Court has invalidated retroactive transfer taxes affecting irrevocable past transactions, where the imposition of tax was not reasonably foreseeable. *See, e.g., Untermeyer*, 276 U.S. at 445-46.

Whether § 641(b)(2) is characterized as a retroactive tax or the retroactive revocation of a substantive right, it clearly constitutes a denial of due process. The government's argument that § 641(b)(2) survives due process scrutiny turns on its premise that there is no evidence that the taxpayers' decedents reasonably relied to their detriment on the § 11(b) exemption. This argument, however, is based entirely on impermissible inferences. If this Court finds that § 11(b) did in fact confer an estate tax exemption for Project Notes, then the taxpayers should be presumed to have known of it — not presumed to have been ignorant of it.

Moreover, the government's argument ignores the significance of the reliance interests of taxpayers, like the *Shackelford* executors, who were aware of the § 11(b) exemption at the time they filed their decedents' returns. Indeed, the agreed facts in *Shackelford* directly contradict the government's contention that § 641 "upsets no settled expectations." Govt. Br. p. 39. Thus, although the *Shackelford* executors adopt the taxpayers' arguments concerning their decedent's reliance interests, the *Shackelford* executors urge this Court to consider the reliance interests of executors as well as decedents in determining the constitutionality of § 641.[*]

[*] In assessing the reliance interests affected by § 641, it is important to bear in mind that, whereas the effective date provision in subsection (b)(1) is triggered by an act *of the decedent* (namely, his death on or after June 19, 1984), the effective date provision in subsection (b)(2) is

(Footnote continued on next page)

It is uncontested that when they filed their decedent's return, the *Shackelford* executors relied on the long-standing statutory framework providing a right to refund of estate taxes. At the time Congress first considered § 641, executors were entitled to recover any estate tax they had overpaid. Under the Internal Revenue Code, an executor may make a claim for refund of estate tax within three years of the time the estate tax return was filed or two years from the time the tax was paid, whichever period expires later. 26 U.S.C. § 6511(a). Section 7422 specifically entitles an executor to bring suit for the recovery of estate tax "erroneously or illegally assessed or collected." 26 U.S.C. § 7422. "[S]uch [refund] suit or proceeding may be maintained whether or not such tax, penalty or sum has been paid under protest. . . ." 26 U.S.C. § 7422(b). Thus, the voluntary deposit of a tax overpayment is not considered a waiver of a taxpayer's right to recover such overpayment. This procedure has been in place since 1924. *See George Moore Ice Cream Co. v. Rose*, 289 U.S. 373, 375-77 (1933).

There can be no question that the *Shackelford* executors justifiably relied to their detriment on their right to obtain a refund of estate taxes paid on their decedent's Project Notes. The government conceded in *Shackelford* that the executors were aware when they filed the estate tax return of the estate tax exemption for Project Notes and of the IRS's intention to appeal the *Haffner* decision. If the *Shackelford* executors had claimed an exemption for the Project Notes on the tax return and *Haffner* were later reversed on appeal, the estate would have faced heavy interest assessments and penalties. Because executors are under a fiduciary duty to conserve the assets of the estate and to take conservative tax positions (*see Estate v. United States*, 641 F.2d 339,

(Footnote continued from preceding page)
triggered by an act *of the executor* (the filing of an estate tax return showing the Project Notes as subject to estate tax). It is therefore appropriate to focus on the knowledge, expectations and reliance interests of executors at the time they filed their decedent's return, as well as the expectations of the decedent.

344 (5th Cir. 1981)), the *Shackelford* executors opted to report the Project Notes, specifically reserving their statutory right to file a refund claim should the *Haffner* decision be affirmed. In doing so they were well aware that the mere inclusion of a disputed item on a return is not a waiver of the right to prosecute a refund claim."

The enactment of § 641 of DEFRA, if applied retroactively, irrevocably frustrates executors' reliance on their right to seek an estate tax refund. Under subsection (b)(2), as retroactively applied, the *Shackelford* executors were forever precluded from exercising that right by the fact that they had filed their estate tax return one month before DEFRA was passed. The government concedes that the *Shackelford* executors had no notice of § 641 at the time they filed their return. If they had been given notice that the mere act of reporting the Project Notes on the return would waive their refund rights, obviously they would have treated the Notes as nontaxable.

Properly viewed, § 641 operates to eliminate retroactively the statutory limitations period within which the taxpayers were otherwise entitled to file a claim for refund. The Court has consistently invalidated such attempts to deprive individuals of a reasonable time within which to pursue a right of action. As the Court stated in *Ochoa v. Hernandez y Morales*, 230 U.S. 139, 161-62 (1913):

> With reference to statutes of limitations, it is well settled that they may be modified by shortening the time prescribed, but only if this be done while the time is still running, and so that a reasonable time still remains for the commencement of an action before the bar takes effect.

"It is, in fact, a common practice for executors to make overdeposits of estate tax while the taxability of an item is in dispute. "In order to avoid possible penalties and interest, executors frequently make a payment to the collector prior to the determination and assessment of estate tax due." 1951-52 *Montgomery's Federal Taxes, Estate, Trust and Gift* 922 (1952).

See also Buffalo-Pitts Land Co. v. *F.B. Williams Cypress Co.*, 258 U.S. 190, 197 (1922); *United States* v. *Myerna*, 245 U.S. 392, 397 (1918).

Under the Internal Revenue Code, executors can file a claim for refund within three years after filing their decedent's estate tax return. 26 U.S.C. § 6511. After the enactment of § 641 however, those executors, like the taxpayers in this case, who had previously filed estate tax returns treating Project Notes as taxable, would be forever barred from claiming a refund. Therefore, the government's interpretation of § 641 would effectively cut off, without notice, the limitations period as of the date the return was filed.

The *Shackelford* executors agree with the taxpayers in this case that the retroactive application of § 641(b)(2) unconstitutionally infringes on the reliance interests of decedents who purchased Project Notes. As the foregoing discussion demonstrates, however, the reliance interests of taxpayers such as the *Shackelford* executors are equally relevant to the constitutionality of that provision. The *Shackelford* executors therefore urge this Court to consider their reliance interests and the reliance interests of similarly-situated executors.[*]

[*] A retroactive application of § 641 is particularly invidious because it would exonerate taxpayers who failed to report Project Notes or, even worse, failed to file a tax return. There can be no justification for a statute that rewards such unscrupulous taxpayers while penalizing forthright taxpayers, such as the appellees and the *Shackelford* executors, who in reliance on the long-standing refund procedures reported the Project Notes. The government's interpretation would constitute an ill-advised policy that could undermine our system of self-assessment, compliance and voluntary taxpayer disclosure. Future taxpayers, mindful that their refund rights could be waived by failing to assert a position on a return at the earliest opportunity, would be encouraged to take the most aggressive position and not to report potentially taxable transactions.

B. Section 641, as Construed by the Government, Confiscated the Taxpayers' Refund Claims in Violation of the Taking Clause of the Fifth Amendment.

The fifth amendment's prohibition against the taking of property without just compensation extends to instances where the taking is made under the guise of the congressional taxing power. *Steward Machine Co.* v. *Davis*, 301 U.S. 548, 585 (1937); *Dane* v. *Jackson*, 256 U.S. 589, 599 (1921); *Kohl Industrial Park Co.* v. *County of Rockland*, 710 F.2d 895, 899-900 (2d Cir. 1983). Section 641, as interpreted by the government, effectively confiscated taxpayers' claims for refund in violation of the taking clause. The taxpayers affected are entitled to just compensation for this appropriation of estate property by the government.

Lower federal courts have recognized that the fifth amendment requires that the government compensate a party for the loss of a tax exemption resulting from the government's conduct. In *United States* v. *68,716 Square Feet of Land*, 79 F. Supp. 438 (S.D.N.Y. 1948), *rev'd on other grounds sub nom. United States* v. *City of New York*, 175 F.2d 75 (2d Cir. 1949), *cert. denied*, 338 U.S. 885 (1949), the federal government's use of a private hospital caused the hospital to lose its vested right in an exemption from city property taxes. The court held that the fifth amendment dictated that the "United States must compensate for the [hospital's] increased tax burden. . . ." *Id.* at 441. Here, the taxpayers' loss of the estate tax exemption was a direct result of the Congress's action in passing § 641. This is likewise a taking without just compensation in violation of the fifth amendment.

Conclusion

For the foregoing reasons, the Court should affirm the decision of the district court that § 641(b)(2) of DEFRA may not constitutionally be applied to deprive executors of their vested right to an estate tax refund pursuant to § 11(b) of the Housing Act of 1937.

Respectfully submitted,

Atwell W. Somerville
Somerville, Moore & Somerville
Sovran Bank Building
Post Office Box 629
Orange, Virginia 22960
(703) 672-3200

James J. Carroll*
Holly A. Harrison
Gerald D. Kelly
Sidley & Austin
One First National Plaza
Chicago, Illinois 60603
(312) 853-7000

Counsel for Amici Curiae
*Counsel of Record

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AMICUS CURIAE

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

UNITED STATES OF AMERICA,

Appellant,

v.

WELLS FARGO BANK, ET AL.,

Appellees.

UNITED STATES OF AMERICA,

Appellant,

v.

HARRY ROSENBERG AND ARTHUR ROSEN, ETC.,

Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE CENTRAL DISTRICT OF CALIFORNIA

BRIEF OF HERBERT K. CUMMINGS, BEATRICE C. MAYER AND RUTH C. SORENSEN, EXECUTORS OF THE ESTATE OF NATHAN CUMMINGS, AS *AMICI CURIAE* IN SUPPORT OF APPELLEES

MORTIMER M. CAPLIN*
STUART L. BROWN
Caplin & Drysdale
One Thomas Circle, N.W.
Washington, D.C. 20005
(202) 862-5000

JAMES J. CARROLL
HOLLY A. HARRISON
GERARD D. KELLY
Sidley & Austin
One First National Plaza
Chicago, Illinois 60603
(312) 853-7000

Counsel for Amici Curiae
*Counsel of Record

QUESTION PRESENTED

Did the Housing Act of 1937, which provides that obligations issued by public housing agencies "shall be exempt from all taxation now or hereafter imposed by the United States . . . ," exempt the transfer of such obligations from federal estate tax?

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IN THE

Supreme Court of the United States

October Term, 1987

No. 86-1521

UNITED STATES OF AMERICA,

Appellant,

v.

WELLS FARGO BANK, ET AL.,

Appellees.

UNITED STATES OF AMERICA,

Appellant,

v.

HARRY ROSENBERG AND ARTHUR ROSEN, ETC.,

Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE CENTRAL DISTRICT OF CALIFORNIA

BRIEF OF HERBERT K. CUMMINGS, BEATRICE C. MAYER AND RUTH C. SORENSEN, EXECUTORS OF THE ESTATE OF NATHAN CUMMINGS, AS *AMICI CURIAE* IN SUPPORT OF APPELLEES

The *amici curiae*, Herbert K. Cummings, Beatrice C. Mayer and Ruth C. Sorensen, executors of the estate of Nathan Cummings, submit this brief in support of the appellee taxpayers.[1]

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[1] Letters in which each of the parties have consented to the filing of this brief have been filed with the Clerk of the Court pursuant to United States Supreme Court Rule 36.2.

INTEREST OF THE *AMICI CURIAE*

The *amici curiae*, Herbert K. Cummings, Beatrice C. Mayer and Ruth C. Sorensen, are the executors of the estate of Nathan Cummings, deceased. At issue in proceedings pending on behalf of their decedent before the Internal Revenue Service is whether the transfer of public housing agency obligations issued pursuant to the Housing Act of 1937 ("Project Notes") was subject to transfer taxes. The Internal Revenue Service is asserting transfer tax liability based on its position (Revenue Ruling 81-63, 1981-1 C.B. 455) that §11(b) of the Housing Act of 1937 does not exempt the transfer of Project Notes from taxation. The *amici curiae* are contesting the proposed tax assessments against their decedent's estate.

The *amici curiae* therefore will be directly affected by the Court's ruling on whether §11(b) of the Housing Act of 1937 exempts the transfer of Project Notes from federal transfer taxation. The *amici curiae* submit this brief to assist the Court in the correct resolution of that issue. Because §641 of DEFRA is not applicable to the transfer of their decedent's Project Notes, the *amici curiae* do not address the issues of the construction or constitutionality of that statute.[2]

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[2] Unlike the taxpayers in the instant case, the *amici curiae* at no time "filed an estate or gift tax return showing such transfer as subject to federal estate or gift tax." Deficit Reduction Act of 1984, §641, Pub. L. No. 98-369, 98 Stat. 494 ("DEFRA"). Moreover, the transfer of the decedent's Project Notes occurred *before* June 19, 1984. Thus, §641 of DEFRA, which purports to apply to the taxpayers in the instant case, is by its terms inapplicable to the transfer of Project Notes of the *amici curiae*'s decedent.

SUMMARY OF ARGUMENT

The Housing Act of 1937, on its face, exempted Project Notes from transfer taxes. Section 5(e) of the Housing Act of 1937 expressly exempted public housing agency obligations from "all taxation now or hereafter imposed by the United States . . . ."[3] Section 20(b) of the same Act, in contrast, exempted obligations issued by the United States Housing Authority from "all taxation (except surtaxes, estate, inheritance, and gift taxes)." The presence of the exception for estate taxes in §20(b) but not in §5(e) demonstrates that Congress intended §5(e)'s unqualified exemption to encompass estate taxes.

Congress, in structuring the Housing Act of 1937, employed language virtually identical to a comparable set of parallel exemptions in the Victory Liberty Loan Act of 1919, ch. 100, 40 Stat. 1309. In the Victory Liberty Loan Act, Congress likewise employed an unqualified exemption in one section, and a parallel exemption in another section which, however, contained an express exception for estate taxation. *Id.*, §§1, 4. The unqualified exemption in the Victory Liberty Loan Act was interpreted to include an estate tax exemption — just as Congress had intended. Thus, in 1937, Congress had clear precedent for using the language in §5(e) of the Housing Act to grant an estate tax exemption.

This construction of the Housing Act is confirmed by three distinct but mutually reinforcing elements of the legislative history. First, the Senate Committee on Education and Labor, which considered the housing bill, rejected Secretary of the Interior Ickes's proposed amendment to the

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[3] Section 5(e), with certain minor language changes, was renumbered §11(b) by the Housing and Community Development Act of 1974, ch. 338 Pub. L. No. 93-383, 88 Stat. 633 (1974), and is presently codified at 42 U.S.C. §1437i(b).

bill, which would have inserted into §5(e) a parenthetical exception expressly making such obligations subject to transfer taxation. Second, Senator David I. Walsh, who for several years had presided over committee hearings on the housing bill and its predecessors, explained on the floor of the Senate that "the bill gives the public housing agencies the right to issue tax-exempt bonds, which means they are free from income tax, surtax, es'ate, gift, and inheritance taxes." 81 Cong. Rec. 8085 (1937). There is no suggestion in the record that any Senator disagreed with Senator Walsh on the scope of the tax exemption. Moreover, Senator Walsh's explanation was confirmed by the contemporaneous statement of Warren Jay Vinton, the draftsman of most of the Housing Act of 1937. Third, the official Committee Summary stated that United States Housing Authority obligations would be exempt from all taxation "except inheritance, gift, and estate taxes," whereas public housing agency obligations would be exempt from "all taxation" without exception.

The existence of the estate tax exemption in §5 (e) does not, as the government contends, rest on implication. Rather, it is based on the express language of the tax exemption and the meaning Congress intended such language to have. The Court's holdings in *Plummer* v. *Coler*, 178 U.S. 115 (1900), and *Murdock* v. *Ward*, 178 U.S. 139 (1900), that an exemption of property from taxation generally does not exempt the transfer of such property from succession taxes, apply only in the absence of a contrary legislative intent. These cases merely state a general rule of construction — a rule that must yield where Congress, in enacting a tax exemption, plainly manifests its intent to include transfer taxes within the scope of the exemption. It is the paramount function of this Court to ascertain that intent and to give it effect.

ARGUMENT

The taxpayers' position that §5 (e) of the Housing Act of 1937 exempted Project Notes from the federal estate tax rests on the explicit language of the statute and on the legislative history that explains the meaning Congress intended that language to have. The government's position, on the other hand, is grounded on erroneous legal premises regarding the role of the judiciary in interpreting statutory language, on impermissible inferences attributing error, inadvertence and ignorance to members of Congress, and on *ex post* policy arguments that ignore the conditions in 1937 and the policies adopted in response thereto.

First, the government mischaracterizes the import of the principle enunciated in *Plummer* v. *Coler*, 178 U.S. 115 (1900), and *Murdock* v. *Ward*, 178 U.S. 139 (1900). In those cases, this Court noted that a statutory exemption from "all taxation" generally does not extend to transfer taxes. *See also United States Trust Co.* v. *Helvering*, 307 U.S. 57 (1939). However, contrary to the government's interpretation, those cases did not state an inviolate rule of decision, but rather a general rule of statutory construction applicable only in the absence of the expression of contrary intent by Congress.

Second, the government urges this Court to ignore Congress's clearly-manifested intent to exempt §5(e) obligations from transfer tax, and to draw upon impermissible assertions regarding congressional motives. It is revealing that the government is unable to point to a single indication in the language or legislative history of the Housing Act that such an exemption was not intended. Instead, the government attempts to discredit the affirmative indications of Congress's intent by offering purely hypothetical alternative analyses. Each of the government's conjectures, however, necessarily assumes that Congress acted carelessly or that certain of its members were mistaken or ignorant about the

scope of the legislation. The government's hypothetical arguments cannot override clear manifestations of Congress's intent.

Third, the government consistently attempts to have this Court analyze the Housing Act of 1937 based on policy considerations it perceives to be paramount in 1987. (Govt. Br. pp. 10, 21, 35). However, any discussion of the intent of Congress must take into account conditions at the time of enactment. Although the government describes an estate tax exemption for public housing authority bonds as "implausible" (Govt. Br. p. 35), when the legislation is viewed in the context of the state of the national economy and the housing situation in 1937, it is clear that Congress had sound reasons for granting a broad tax exemption. Many members of Congress objected to placing the entire financial burden for funding low-income housing on the federal government. 81 Cong. Rec. 9246 (1937). At the same time, because the nation was in the depths of the Depression, municipalities already had serious debt problems. *United States Housing Act of 1936: Hearings on S. 4424 Before the Senate Comm. on Education and Labor*, 74th Cong., 2nd Sess. 31, 74 (1936). Congress thus enacted broad tax-exemption provisions to provide special incentives that would enable local housing authorities to provide the necessary funding for low-income housing projects. *Hearings on H.R. 5033 and S. 1685 Before the House Comm. on Banking and Currency*, 75th Cong., lst Sess. 199 (1937).

I. THE GENERAL PRINCIPLE EXPRESSED IN *PLUMMER* V. *COLER* AND *MURDOCK* V. *WARD* CANNOT OVERRIDE A CLEARLY-MANIFESTED CONGRESSIONAL INTENT TO GRANT AN ESTATE TAX EXEMPTION.

In *Plummer* and *Murdock*, the Court recognized that an inheritance or estate tax is an excise tax on the transfer of

property, not a tax on the property itself. The *amici curiae* do not challenge that basic principle, which correctly characterizes the estate tax as a transfer tax. The *amici curiae* do, however, dispute the government's attempt to extract as a corollary of that principle an irrebuttable presumption that an exemption from "taxation" or "all taxation" can *never* include an estate tax exemption. If Congress intends such an exemption to extend to the estate tax, such intent must control over any principle of statutory construction. *American Bank & Trust Co.* v. *Dallas County*, 463 U.S. 855 (1983); *see also Jandorf's Estate* v. *Commissioner*, 171 F.2d 464 (2d Cir. 1948); *Haffner* v. *United States*, 585 F. Supp. 354 (N.D. Ill. 1984), *aff'd*, 757 F.2d 920 (7th Cir. 1985) (*per curiam*); *Greene* v. *United States*, 171 F. Supp. 459 (Ct. Cl.), *cert. denied*, 360 U.S. 933 (1959). [4]

This Court has explicitly recognized that the rule of construction expressed in *Plummer* must yield where Congress has expressed an intention to create a broad tax exemption. In *American Bank*, 463 U.S. 855, this Court held that the provision of Rev. Stat. §3701, Pub. L. No. 86-346, 73 Stat. 622 (1959) (present version codified at 31 U.S.C. §3124), that "[a]ll stocks, bonds, Treasury notes, and other obligations of the United States, shall be exempt from taxation by or under State or municipal or local authority," extended beyond a mere income tax exemption, notwithstanding the formalistic rule discussed in *Plummer*. *American Bank* presented the issue of whether a Texas property tax on bank shares could properly be assessed on tax-exempt United States obligations held by the bank. *Id.*

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[4] Although the Court has never squarely addressed the issue in the estate tax context, it did hold in *Oklahoma Tax Commission* v. *United States*, 319 U.S. 598 (1942), that a general exemption of Indian land from taxation exempted the transfer of the land from state inheritance taxation. *See also Landman* v. *United States*, 58 F. Supp. 836 (Ct. Cl. 1945), holding that the transfer of such land was also exempt from the federal estate tax.

at 857. The bank contended that the tax exemption of Rev. Stat. §3701, as amended in 1959, included an exemption from such property tax. As originally enacted, §3701 contained a provision generally exempting federal obligations from state and local taxation. In 1959, Congress amended the provision to add an additional sentence: "This exemption extends to every form of taxation that would require that either the obligations or the interest thereon, or both, be considered, directly or indirectly, in the computation of the tax . . . . " *Id.* at 858.

As does the government in the present case, the State of Texas argued that the rule of construction enunciated in *Plummer* mandated a finding that the tax exemption did not extend to taxes on discrete interests, such as the Texas property tax on bank shares. This Court expressly rejected this contention. The Court found that the language of the 1959 amendment, coupled with the House and Senate Reports summarizing the exemption,[5] demonstrated congressional intent to set aside the Court's "formalistic pre-1959 approach to §3701." *Id.* at 862.

As this Court confirmed in *American Bank*, the "primary rule of statutory construction" requires the judiciary to give effect to the intent of Congress. *Rodgers* v. *United States*, 185 U.S. 83, 86 (1902). Because rules of construction are merely aids for ascertaining legislative intent, they must yield if that intent is otherwise apparent. *National Railroad Passenger Corp.* v. *National Association of Railroad Passengers*, 414 U.S. 453, 458 (1974). The principle of construction in *Plummer* and *Murdock* is thus inapplicable to an exemption, such as the one contained in §5(e) of the

[5] The Senate Report stated that "both the principal and interest on U.S. obligations are exempt from all state taxes [with specified exceptions]." *American Bank*, 463 U.S. at 864 n.8 (*quoting* S. Rep. No. 909, 86th Cong., 1st Sess., 11 (1959)).

Housing Act, where Congress has clearly expressed an intent that the exemption include estate taxes.[6]

II. THE LANGUAGE AND THE LEGISLATIVE HISTORY OF THE HOUSING ACT CONSIDERED AS A WHOLE CONCLUSIVELY DEMONSTRATE THAT CONGRESS INTENDED TO EXEMPT THE TRANSFER OF PROJECT NOTES FROM ESTATE TAXATION.

The government's speculation as to the scope and meaning of the Housing Act is devoid of any support in the statute or the legislative record. It is predicated solely on a misconstruction of *Plummer*, *Murdock* and their progeny.[7] The position of the taxpayers and the *amici curiae*, on the other hand, is fully supported by what Congress said and wrote when it passed the Housing Act.

[6] The *amici curiae's* position that the rulings in *Plummer*, *Murdock* and *United States Trust Co.* are *general* principles that must give way to a contrary Congressional intent is supported by Treasury Regulation §20.2033-1(a), described by the government as an embodiment of the "well-established rule . . . . " (Govt. Br. p. 19). The Regulation states:

> Various statutory provisions which exempt bonds, notes, bills and certificates of indebtedness of the Federal Government or its agencies and the interest thereon from taxation are *generally* not applicable to the estate tax.

26 C.F.R. § 20.2033-1(a) (emphasis added).

[7] The line of cases that the government mischaracterizes as "an unbroken chain of decisions" is broken by this Court's decision in *Oklahoma Tax Commission*, 319 U.S. 598, as well as *Claflin* v. *Commissioner*, 186 F.2d 307 (2d Cir. 1951) (*per curiam*); *Pennsylvania Co. for Banking & Trusts* v. *United States*, 185 F.2d 125 (3d Cir. 1950); *Jandorf's Estate* v. *Commissioner*, 171 F.2d 464 (2d Cir. 1948); *Greene* v. *United States*, 171 F. Supp. 459 (Ct. Cl.), *cert. denied*, 360 U.S. 933 (1959); *Landman* v. *United States*, 58 F. Supp. 836 (Ct. Cl. 1945); *Loewenstein* v. *Commissioner*, 17 T.C. 60 (1951) (*per curiam*); *Haffner*, 585 F. Supp. 354.

A. The Language of the Housing Act Manifests Congressional Intent to Exempt Project Notes From Transfer Taxes.

As this Court has often stated, "in every case involving the construction of a statute, our starting point must be the language employed by Congress." *Reiter* v. *Sonotone Corp.*, 442 U.S. 330, 337 (1979); *see also United States* v. *Turkette*, 452 U.S. 576, 580 (1981). Section 5(e) of the Housing Act provided as follows:

> Obligations, including interest thereon, issued by public housing agencies in connection with low-rent-housing or slum-clearance projects, and the income derived by such agencies from such projects, shall be exempt from all taxation now or hereafter imposed by the United States.

When §5(e) is read in the light of the tax exemption in §20(b) of the Housing Act for obligations of the United States Housing Authority, it is apparent that Congress affirmatively intended that the §5(e) exemption encompass not only an exemption from regular income taxation, but an exemption from transfer taxes and surtaxes as well. Section §20(b) provided:

> Such obligations shall be exempt, both as to principal and interest, from all taxation (*except surtaxes, estate, inheritance, and gift taxes*) now or hereafter imposed by the United States or by any State, county, municipality, or local taxing authority.

(emphasis added). Section 20(b) expressly excepted estate taxes from the scope of the exemption. The fact that Congress did not similarly except estate taxes from the §5(e) exemption demonstrates that Congress intended the transfer of §5(e) obligations to be exempt from estate tax.

In interpreting the meaning of §5(e), the provision must be construed in the context of the entire statute. Under well-established principles of statutory construction, statutory phrases cannot be construed in isolation; statutes must be read as a whole so as to harmonize the parts and give meaning to each. *United States* v. *Morton*, 467 U.S. 822, 828 (1984). All provisions of a single enactment must be presumed to have been drafted with reference to one another. *United States* v. *American Trucking Association*, 310 U.S. 534, 542-44 (1940).

Moreover, in ascertaining the congressional intent underlying these tax exemptions, this Court is "obliged to give effect, if possible, to every word Congress used." *Reiter*, 442 U.S. at 339; *see also United States* v. *Menache*, 348 U.S. 528, 538-39 (1955). Any interpretation that would render statutory language redundant or inoperative must be avoided. *Colautti* v. *Franklin*, 439 U.S. 379, 392 (1979). Accordingly, this Court should not interpret §5(e) as containing implicit exceptions, given that §20(b), a parallel section of the same statute, contains express exceptions. *See Fedorenko* v. *United States*, 449 U.S. 490, 512 (1981); *cf. Lewis* v. *United States*, 445 U.S. 55, 61-62 (1980).

These principles of statutory construction were applied by this Court in *American Bank*. The exemption at issue in that case expressly excepted franchise and inheritance taxes. The Court relied heavily on the presence of these exceptions in concluding that Congress intended the exemption to extend to all taxes not expressly excepted. It stated that:

> [O]therwise, the specific exemptions [sic] for these taxes would have been superfluous . . . .
>
> . . .
>
> From the specific exceptions for franchise and estate and inheritance taxes, and the conspicuous omission of shares taxes from that group, only one inference is possible: Congress meant to bar shares taxes to that extent they consider federal obligations in the computation of the tax.

American Bank, 463 U.S. at 864.

Similarly, only one permissible conclusion may be drawn from the divergent language of the two tax exemptions in the Housing Act — Congress affirmatively intended to exempt the transfer of §5(e) obligations from estate tax. The fact that the §5(e) exemption and the §20(b) exemption are identical but for the exception in §20(b) for "surtaxes, estate, inheritance, and gift taxes" compels such a finding. The sections can be harmonized and the qualifying language in §20(b) can be given meaning only if §5(e) is construed to include an exemption for transfer taxes.

Contrary to the government's contention, the estate tax exemption here at issue is not based on implication. (Govt. Br. p. 17). Indeed the estate tax exemption for Project Notes was expressed in language virtually identical to that which Congress had used to achieve an estate tax exemption for Liberty Bonds some 18 years earlier. One section of the Victory Liberty Loan Act of 1919, ch. 100, §4, 40 Stat. 1309, exempted from "all taxation" Liberty Bonds owned by foreign investors. A parallel section of the same Act exempted such obligations in the hands of U.S. investors from "all taxation (except estate and inheritance taxes)." *Id.* at §1. First in *Farmers' Loan & Trust Co.* v. *Bowers*, 22 F.2d 464 (S.D.N.Y. 1927), *modifying* 15 F.2d 706 (S.D.N.Y. 1926), *rev'd on other grounds*, 29 F.2d 14 (2d

Cir. 1928), and then in *Jandorf's Estate* v. *Commissioner*, 171 F.2d 464 (2d Cir. 1948), the courts held that the unqualified tax exemption extended to the estate tax. Like the tax exemption for Liberty Bonds, the estate tax exemption for Project Notes is based on the express language of the exemption "from all taxation now or hereafter imposed by the United States . . . . "[8] The Court must determine the meaning Congress intended those words to have. Everything in the record indicates that Congress intended the §5(e) exemption to encompass estate taxes. Not a scintilla of evidence, on the other hand, supports the government's surmises as to the meaning of that exemption.

B. The Government's Speculation Concerning the Meaning of the Language of the Housing Act Is Totally Without Foundation.

The government posits alternative explanations, based entirely on conjecture, for the conspicuous omission of an exception for transfer taxes in §5(e). It attempts to attribute the difference in the two tax exemptions to the "completely different purposes of the two sections of the 1937 Act." (Govt. Br. p. 22). The government correctly points out that Congress intended to create a broader tax exemption in §5(e) for state and local housing agency obligations than the §20(b) tax exemption conferred on United States Housing Authority obligations. *Id.* However, this assertion actually supports the taxpayers' argument that, in enacting §5(e), Congress intended to create extraordinary incentives for the purchase of obligations such as Project Notes — incentives that included a transfer tax exemption.

The government's argument that §5(e) and §20(b) should be construed without reference to one another merely because the two provisions had different purposes

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[8] The *Haffner* court noted that *Jandorf's Estate* was "practically on all fours . . . " with the case before it. *Haffner*, 585 F. Supp. at 359.

(Govt. Br. pp. 22-26) completely ignores the well-established principles of statutory construction discussed above. *See* pp. 11-12, *supra*. Different provisions within the same act must be construed with reference to one another. *American Trucking Association*, 310 U.S. at 542-44. If this rule could be abrogated by the mere fact that the provisions at issue had different purposes, then the rule would have no meaning whatsoever.

Furthermore, the government's contentions concerning what it supposes to have been the purpose of §5(e), and the need to include an explicit exemption for the "interest thereon," are simply irrelevant. (Govt. Br. pp. 22-25). Even if these assertions were correct, they would merely explain the presence of the exemption in §5(e). They would not explain the difference in language between the §5(e) and §20(b) exemptions.

The government's dissertation on the significance of the surtax exception in §20(b) is similarly nothing more than an attempt to distort and obscure Congress's true intent. Under the government's theory, Congress inserted the estate and gift tax exceptions only because of the surtax exception. In the government's words, the transfer tax and the surtax exemption were "an inseparable couple," with the express exception for transfer taxes owing its existence solely to the presence of the surtax exception. (Govt. Br. p. 29).

The government's "surtaxes" theory is logically inconsistent. The government speculates that, because surtaxes were to be excepted from the §20(b) tax exemption for United States Housing Authority obligations, estate and gift taxes were also expressly excepted from the §20(b) tax exemption only to avoid an inference that such obligations were exempt from estate and gift taxes. The government attributes the parenthetical exception for estate and gift

taxes to "sensible draftsmanship." (Govt. Br. p. 29). However, if the draftsmen of the Housing Act were careful enough to except estate and gift taxes from the §20(b) exemption, they would have similarly excepted estate and gift taxes from the §5(e) exemption, if such exceptions were in fact intended.

Moreover, far from being "an inseparable couple," exceptions for estate and gift taxes have commonly appeared in tax exemptions *where there are no exceptions for surtaxes*. For example, §464(p) of the Federal Deposit Insurance Act provides:

> All . . . obligations issued by the [Federal Deposit Insurance] Corporation shall be exempt both as to principal and interest, from all taxation (*except estate and inheritance taxes*) now or hereafter imposed by the United States.

12 U.S.C. §1825 (emphasis added). As recently as 1970, long after the surtax had been repealed, Congress passed a law providing that obligations of the Postal Service shall:

> be exempt both as to principal and interest from all taxation now or hereafter imposed by any State or local taxing authority *except estate, inheritance, and gift taxes* . . . .

39 U.S.C. §2005(d)(4) (emphasis added). [9] If the government's argument is correct, then it is impossible to explain why Congress has repeatedly included exceptions for estate tax in other tax exemption provisions where "surtaxes" were not even mentioned.

The government cannot have it both ways. Either the draftsmen of the Housing Act were consistently careful or

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[9] Other examples of tax exemptions containing exceptions for estate tax, but not for surtaxes, appear in the Appendix to this brief.

they were careless. Under established rules of statutory construction, this Court should presume that the drafting was consistently careful. Read together and in the light of the legislative history, the language of the two tax exemptions leads to the inescapable conclusion that the draftsmen did not except estate tax from the §5(e) exemption because Congress specifically intended public housing agency obligations to be exempt from estate tax.[10]

There is no need to speculate 50 years after the event, as the government does, concerning the intentions of the draftsmen. Warren Jay Vinton, the most important of those draftsmen, explained in 1937 that §5(e) was drafted to encompass an exemption from transfer taxes. *See* pp.23-24, *infra*. Senator Walsh, the spokesman for the bill on the floor of the Senate, likewise stated that obligations issued by

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[10] Nothing in the legislative history of either the 1949 Housing Act or the Housing and Community Development Act of 1974, ch. 338, Pub. L. No. 93-383, 88 Stat. 653, supports the government's assertion that "subsequent legislation dissipated" the estate tax exemption. (Govt. Br. p. 35 n.19). The Housing Act of 1949 did not amend §5(e) of the Housing Act of 1937. Indeed, the legislative history of the 1949 Act demonstrates that Congress expressly considered amendment of §5(e) and opted not to change it. S. Rep. No. 84, 81st Cong., 2d Sess. 2 (1949); *see Haffner*, 585 F. Supp. at 361. The 1974 Act carried the exemption forward and renumbered it as §11(b) of the Housing Act of 1937, 42 U.S.C. §1437i(b) (1985). Certain minor language changes were made. For example, the words "whether paid by such agencies or by the Secretary" were added. The legislative history indicates that this language was inserted simply "to make it clear that this exemption applies whether the obligations are paid by the public housing agencies or by the Secretary [of HUD]." S. Rep. No. 693, 93d Cong. 2d Sess. 3 (1974). "The re-enacted sections are to be given the same meaning they had in the original statute unless a contrary intention is plainly manifested." *United States* v. *Le Bris*, 121 U.S. 278, 280 (1887); *see also Pacific Mail Steamship Co.* v. *Joliffe*, 69 U.S. 450, 458 (1865). The legislative history of the 1974 amendment is devoid of any intent to change the tax exemption for obligations of public housing agencies. Thus, the government's argument concerning the impact of subsequent legislation is totally baseless. *See Haffner*, 585 F. Supp. at 361.

public housing agencies were to be "free from income tax, surtax, estate, gift and inheritance taxes." 81 Cong. Rec. 8076 (1937); *see* pp. 18-20, *infra*.

The fact that §5(e) did not contain an express exception for surtaxes only supports the taxpayers' contention that Congress intended to exempt public housing agency obligations from surtaxes. As the government itself emphasizes, an exemption from surtaxes was an extraordinary exemption. [11] The government likewise acknowledges that Congress intended the §5(e) tax exemption to have a broader effect than the §20(b) exemption by including an exemption from surtax. (Govt. Br. pp. 26-27). Thus, the government's repeated contention that an estate tax exemption could not have been intended because it is an extraordinary measure loses all significance, since such an extraordinary measure would be entirely consistent with Congress's admitted intention to create a broad and extraordinary exemption.

C. The Legislative History of the Housing Act Confirms That the Transfer of Project Notes Was Intended to Be Exempt From Taxation.

The Housing Act, including its tax exemption provisions, originated in the Senate Committee on Education and Labor. In 1937, the Committee held several days of hearings on the Wagner Housing Bill (S. 1685). The Wagner Housing Bill contained the identical tax exemption provisions discussed above, and was later enacted as the Housing Act

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[11] At the time the Housing Act was passed, there were two components to the federal income tax: the "normal" tax on income, at a fixed rate of 4%, and a surtax, with rates graduated up to 75%. Revenue Act of 1936, ch. 690, §§11 and 12, 49 Stat. 1648, 1653-55.

of 1937. Senator David I. Walsh, Acting Committee Chairman, presided over the hearings. Senator Walsh was a manager of the bill in the Senate and later became a conferee.[12] 81 Cong. Rec. 9584 (1937).

At the Committee hearings, Secretary of the Interior Harold L. Ickes proposed an alternate version of the bill (the "Ickes Bill"). Unlike the Wagner Bill, the Ickes Bill proposed the insertion of an express exception for "estate, inheritance, and gift taxes" in §5(e):

> Sec. §5(e) . . . Obligations issued by public housing agencies in connection with low-rent-housing and slum-clearance projects, and the income derived by such agencies from such projects, shall be exempt from all taxation *(except estate, inheritance, and gift taxes)* now or hereafter imposed by the United States.

To Create a United States Housing Authority: Hearings on S. 1685 Before the Senate Comm. on Education and Labor, 75th Cong., lst Sess. 59, 64 (1937) (emphasis added). Thus, the Ickes bill would have made the §5(e) obligations subject to transfer taxes. The Committee did not adopt the Ickes version of the §5(e) exemption.

On July 23, 1937, the Committee reported the Wagner Bill to the Senate. 81 Cong. Rec. 7464 (1937). On August 3, Senator Walsh addressed the Senate on behalf of the Committee, speaking in favor of the bill. Prefacing his discussion of its provisions, Senator Walsh said:

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[12] During 1935 and 1936, the Committee considered bills similar to the Housing Act of 1937, neither of which were enacted. Several weeks of hearings were held by the Committee on those bills. Senator Walsh, then Chairman of the Committee, presided over those hearings as well. 81 Cong. Rec. 8076 (1937).

> I was chairman of the Committee on Education and Labor last year when extensive hearings were held on a bill similar in character to the one now pending. This year, because of the unfortunate illness of the Senator from Alabama [MR. BLACK], it fell to my lot to preside over the hearings on the pending bill, which were also of several days' duration. I rise not merely for the purpose of seeking to influence the Members of the Senate in favor of this proposed legislation but rather to perform what I think is a very important duty for a member of an important committee dealing with an important bill, *namely, to put in the RECORD the viewpoint of the committee and the viewpoint of at least some Members of the Senate with respect to certain features of the authority and power granted by the bill.*

81 Cong. Rec. 8076 (1937) (emphasis added).

Senator Walsh gave a detailed explanation of "every financial feature of the bill." *Id.* at 8085. He expressly stated that the tax exemption for obligations of public housing agencies included an exemption from surtaxes, estate, gift and inheritance taxes as well as from income tax:

> *Obligations*, including interest thereon, *issued by public housing agencies*, and income derived by such agencies on such projects *are to be exempt from all taxation now or hereafter imposed by the United States. In other words, the bill gives the public housing agencies the right to issue tax-exempt bonds, which means they are free from income tax, surtax, estate, gift, and inheritance taxes.*

Id. (emphasis added).

At the conclusion of Senate discussion of the Wagner Bill, Senator Walsh submitted the Committee's Summary of the bill for inclusion in the record. The Summary was placed in the record without objection. *Id.* Consistent with Senator Walsh's explanation, the Summary reports that "obligations including interest issued by public housing agencies and the income from such projects shall be exempt from taxation by the United States," but that obligations issued by the United States Housing Authority "shall be exempt from taxation *except inheritance, gift, and estate taxes* both as to principal and interest." *Id.* at 8087, 8088 (emphasis added).

Moreover, the fact that Senator Walsh's characterization of the breadth of the §5(e) exemption was not contradicted by any Senator further confirms that it accurately represented Congress's intention. During Senator Walsh's presentation, fourteen Senators commented substantively or asked questions. Not a single Senator disputed Senator Walsh's explanation of the §5(e) exemption.

All the more significant is the silence of Senator Robert Wagner, who "drafted the bill, . . . introduced it, and . . . has been deeply interested in the subject." 81 Cong. Rec. 8080. As the district court observed in *Haffner*, although Senator Wagner "was present during Senator Walsh's presentation and commented frequently, correcting Senator Walsh on occasion, . . . he did not dispute Senator Walsh's characterization of Section 5(e)." *Haffner*, 585 F. Supp. at 359 n.5 (citation omitted). The Court has stated that " 'the silence of sponsors of [bills] is pregnant with significance.' " *Woodwork Manufacturers Association* v. *NLRB*, 386 U.S. 612, 640 (1967), (*quoting NLRB* v. *Fruit & Vegetable Packers & Warehousemen, Local 760*, 377 U.S. 58, 68 (1964)). Senator Wagner's agreement with Senator Walsh's explanation is consistent with his previously-expressed view that the housing legislation should

provide "[e]very inducement" for investors to buy the obligations of local public housing agencies. [13] *United States Housing Act of 1936: Hearings on S. 4424 before Senate Committee on Education and Labor*, 74th Cong., 2d Sess. 17 (1936).

The government attempts to detract from the authority of Senator Walsh's unambiguous remarks by attributing ignorance and error to the Senator. First, the government contends that Senator Walsh's statement that the tax-exempt bonds were free from estate, gift and inheritance tax reflected Senator Walsh's mistaken understanding of the ordinary meaning of tax-exempt bonds. (Govt. Br. p. 32). Second, the government argues that Senator Walsh's characterization of the tax exemption was contrary to the intention of Congress. *Id.*

The government lifts Senator Walsh's remarks out of context in arguing that the phrase "which means" preceding his explanation of the tax exemption refers to generic "tax-exempt bonds." *Id.* Senator Walsh was, in fact, referring specifically to the tax-exempt bonds to be "issued by public housing agencies," as the preceding sentence from this quotation clearly indicates. *See* p. 19, *supra*. Those agencies, Senator Walsh stated in that sentence, were to have the power to issue bonds that "are to be exempt from all taxation now or hereafter imposed by the United States." 81 Cong. Rec. 8085 (1937).

The government's contention that Senator Walsh misspoke as to Congress's understanding of the scope of the

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[13] In his dissent to the Seventh Circuit decision in *Haffner*, Judge Posner attempted to explain away Senator Wagner's silence by suggesting that "since Homer nods, maybe Senator Wagner did too, on this occasion." *Haffner* v. *United States*, 757 F.2d 920, 922 (7th Cir. 1985) (Posner, J., dissenting). However, Judge Posner fails to acknowledge that his argument necessarily assumes that every other Senator present was nodding as well.

§5(e) exemption is equally unsupportable. Legislators are presumed to know the law. *Director, Office of Workers' Compensation Programs* v. *Perini North River Associates*, 459 U.S. 297, 319-20 (1983). Not only is this presumption in Senator Walsh's favor, the record also demonstrates that Senator Walsh knew whereof he spoke. Senator Walsh was a member of the Senate Finance Committee, which deals with tax legislation, for sixteen years. *Congressional Directories*, 1922-1937. He was also chairman or acting chairman of the committee considering housing legislation that ultimately became the Housing Act from 1935 through 1937.

Because he was a manager of the bill and was intimately involved in its development, Senator Walsh's remarks must be given great weight. *Lewis* v. *United States*, 445 U.S. 55, 63 (1980); *Browder* v. *Tipton*, 630 F.2d 1149, 1151-52 (6th Cir. 1980). *Cf.*, *Woodwork Manufacturers Association*, 386 U.S. at 640; *Mastro Plastics Corp.* v. *NLRB*, 350 U.S. 270, 288 n.22 (1956); *Schwegmann Brothers* v. *Calvert Corp.*, 341 U.S. 384, 394-95 (1951). Indeed, under Treasury Regulations, "floor statements made prior to enactment by one of a bill's managers" are deemed authoritative. 26 C.F.R. §1.6661-3(b)(2), T.D. 8017.[14]

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[14] The government's attempt to minimize the importance of Senator Walsh's remarks by asserting that they are no more than the views of a single senator is inconsistent with the facts and contrary to the decisions of this Court. (Govt. Br. p. 33). Aside from the fact that the government's argument is merely a formalistic attempt to draw dubious distinctions between sponsors, managers, chairmen and acting chairmen, none of the cases on which it relies are at all comparable to the situation under consideration. *Weinberger* v. *Rossi*, 456 U.S. 25 (1982), involved ambiguous remarks inconsistent with the rest of the legislative history. *Consumer Product Safety Commission* v. *GTE Sylvania, Inc.*, 447 U.S. 102 (1980), addressed the significance of post-enactment remarks. In *Chrysler Corp.* v. *Brown*, 441 U.S. 281 (1979), this Court relied on a sponsor's interpretation and other legislative history to construe a statute consistent with the sponsor's remarks; it merely noted that the remarks were not controlling.

Furthermore, during the same period that Senator Walsh served on the Finance Committee, there was judicial precedent confirming an estate tax exemption in a statute which had employed the same approach used in the Housing Act to confer an estate tax exemption. The Victory Liberty Loan Act of 1919, ch. 100, §§1,4, 40 stat. 1309, contained a virtually identical set of tax exemptions. Ten years before Senator Walsh's explanation, *Farmers' Loan & Trust Co.*, 22 F.2d 464, established that the unqualified tax exemption in the Victory Liberty Loan Act included estate taxes. In view of this decision, Senator Walsh had every reason to believe — and correctly so — that Congress's use of the same formula that had been employed in the Victory Liberty Loan Act would likewise accomplish an estate tax exemption in the Housing Act.[15] The Victory Liberty Loan Act of 1919, as construed in *Farmers' Loan & Trust Co.*, provided clear precedent of the manner in which the estate tax exemption was written in the Housing Act.

The accuracy of Senator Walsh's statement is also confirmed by the contemporaneous and unambiguous remarks of Warren Jay Vinton "who wrote most of the [Housing] Act's original draft . . . ," (*The Wagner-Steagall Housing Act*, The Architectural Forum (Sept. 1937)), and who was named the first Chief Economist of the United States Housing Authority. *Who Was Who in America*, Vol. V. 1969-1973 at 745. His address to the American Federation on Housing Authorities on the Housing Act one month after the Act's passage was reported as follows:

> Mind you *the obligations of the local Authorities* — and a mortgage bond is an obligation of a

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[15] The correctness of *Farmers' Loan & Trust Co.* was confirmed 21 years later in *Jandorf's Estate*, 171 F.2d 464.

> local Authority — *are exempt from all Federal taxes, not only normal income taxes but surtax, inheritance tax, and gift tax.* Investments of that nature are getting rare in the country. They are at a premium. The mortgage obligations of the local Authorities ought to command a ready market.

American Federation of Housing Authorities, Inc., Summary Report of Conference of September 24-25, 1937, p. 17 (emphasis added).[16]

As the foregoing discussion demonstrates, the government's argument rests on an impermissible presumption of ignorance on the part of Senator Walsh. Notably, however, the government has been unable to cite a single case supporting the proposition that uncontradicted statements of a bill's manager, describing the meaning of the language used in the bill, may be presumed to be in error. The use of such a presumption can only be regarded as a thinly-veiled effort to substitute the IRS's judgment regarding the wisdom of the § 5(e) exemption for the judgment of the legislature that created it.

Grasping at Judge Posner's characterization of the indicia of congressional intent as "ambiguous tidbits"

[16] Although Mr. Vinton apparently used the term "inheritance taxes" in its colloquial sense, which includes all death taxes, he clearly confirmed Senator Walsh's general explanation of the transfer tax exemption features of §5(e).

(*Haffner*, 757 F.2d at 922),[17] the government impermissibly dismisses each piece of the legislative history as isolated happenstance or mistake. But clearly, these indicia must be viewed collectively — each reinforces the other. Together, they conclusively demonstrate Congress's intent to grant an estate tax exemption.

CONCLUSION

For the foregoing reasons, the Court should uphold the ruling in the district court that the transfer of Project Notes is exempt from the federal estate tax.

Respectfully submitted,

MORTIMER M. CAPLIN*
STUART L. BROWN
Caplin & Drysdale
One Thomas Circle, N.W.
Washington, D.C. 20005
(202) 862-5000

JAMES J. CARROLL
HOLLY A. HARRISON
GERARD D. KELLY
Sidley & Austin
One First National Plaza
Chicago, Illinois 60603
(312) 853-7000

Counsel for Amici Curiae
*Counsel of Record

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[17] Judge Posner's dissent is predicated on his apparent skepticism regarding the wisdom of an estate tax exemption for the Project Notes. *Haffner*, 757 F.2d at 922. Such substitution of the judiciary's judgment for that of the legislature is impermissible. It is not the role of the judiciary to question the wisdom of Congress's policy decisions. True to the structure of our Republic as consisting of separate and equal powers, the courts must give effect to the intent of the legislative branch notwithstanding skepticism or disagreement. *See, e.g., Miller* v. *Youakim*, 440 U.S. 125, 142 (1979); *Tennessee Valley Authority* v. *Hill*, 437 U.S. 153, 194-95 (1978); *United States* v. *Jones*, 527 F.2d 817 (D.C. Cir. 1975).

APPENDIX

Act of April 24, 1917, ch. 4, §6, 40 Stat. 36:

> In addition to the bonds authorized by sections 1 and 4 of the Act of April 24, 1917 (chapter 4, Fortieth Statutes, page 36), the Secretary of the Treasury is authorized to borrow from time to time, on the credit of the United States, to meet public expenditures authorized by law, such sum or sums as, in his judgment, may be necessary, and to issue therefor certificates of indebtedness at not less than par in such form and subject to such terms and conditions and at such rate of interest, not exceeding 3½ per centum per annum, as he may prescribe; and each certificate so issued shall be payable, with the interest accrued thereon, at such time, not exceeding one year from the date of its issue, as the Secretary of the Treasury may prescribe. *Certificates of indebtedness* herein authorized shall not bear the circulation privilege, and the sum of such certificates outstanding shall at no time exceed in the aggregate $2,000,000,000, and *such certificates shall be exempt, both as to principal and interest, from all taxation, except estate or inheritance taxes*, imposed by authority of the United States, or its possessions, or by any State or local taxing authority. (emphasis added).

Act of March 3, 1919, ch. 100, §1, 40 Stat. 1309:

> (b) Series: exemptions. The notes herein authorized may be issued on any one or more of

> the following series as the Secretary of the Treasury may prescribe in connection with the issue thereof:
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> (1) *Exempt, both as to principal and interest, from all taxation (except estate or inheritance taxes)* imposed on September 14, 1917, or thereafter by the United States, any state, or any of the possessions of the United States, or by any local taxing authority. . . . (emphasis added).

Act of June 17, 1929, ch. 26, 46 Stat. 20:

> (b) *All certificates of indebtedness and Treasury bills* issued hereunder (after the date upon which this subdivision becomes law) *shall be exempt, both as to principal and interest, from all taxation (except estate and inheritance taxes)* now or hereafter imposed by the United States, any State, or any of the possessions of the United States, or by any local taxing authority; and the amount of discount at which Treasury bills are originally sold by the United States shall be considered to be interest within the meaning of this subdivision. (emphasis added).

Act of June 17, 1930, ch. 512, 46 Stat. 775:

> (d) *Any gain from the sale or other disposition of Treasury bills* issued hereunder (after the date upon which this subdivision becomes law) *shall be exempt from all taxation (except estate or inheritance taxes)* now or hereafter imposed by the United States, any State, or any of the possessions of the United States, or by any local taxing

authority; and no loss from the sale or other disposition of such Treasury bills shall be allowed as a deduction, or otherwise recognized, for the purposes of any tax now or hereafter imposed by the United States or any of its possessions. (emphasis added).